

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input checked="" type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Government Name City of Harbor Beach	County Huron
Audit Date 6/30/05	Opinion Date 8/17/05	Date Accountant Report Submitted to State: 12/20/05	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ Yes ☒ No 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☒ Yes ☐ No 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☒ Yes ☐ No 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ Yes ☒ No 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ Yes ☒ No 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ Yes ☒ No 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ Yes ☒ No 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ Yes ☒ No 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ Yes ☒ No 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.			✓
Reports on individual federal financial assistance programs (program audits).	✓		
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) Nietzke & Faupel, P.C.			
Street Address 7274 Hartley Street		City Pigeon	State MI
Accountant Signature <i>Brian Hagedorn, CPA</i>		ZIP 48755	Date 12/19/05

**CITY OF HARBOR BEACH
HARBOR BEACH, MICHIGAN**

**FINANCIAL REPORT
JUNE 30, 2005**

CITY OF HARBOR BEACH, MICHIGAN

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CITY OF HARBOR BEACH, MICHIGAN

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Report of Independent Auditors

To the City Council
City of Harbor Beach
Harbor Beach, Michigan 48441

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Harbor Beach, Michigan, as of and for the year ended June 30, 2005, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Harbor Beach, Michigan's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Harbor Beach, Michigan, as of June 30, 2005, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 17, 2005, on our consideration of the City of Harbor Beach, Michigan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages iii through xii and 30 through 33, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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Report of Independent Auditors (Continued)

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Harbor Beach, Michigan's basic financial statements. The combining and individual nonmajor fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Nietzke + Faupel, PC

NIETZKE & FAUPEL, P.C.
PIGEON, MICHIGAN

August 17, 2005

**CITY OF HARBOR BEACH
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR – July 1, 2004 to June 30, 2005**

The management of the City of Harbor Beach presents this narrative financial information to readers of the City's financial statements. It contains an objective overview and analysis of the financial position of the City as of and for the twelve month period ended on June 30, 2005. As management of the City, we encourage readers to consider information contained in this discussion and contained in the City's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- > The City's assets exceeded its liabilities at the end of the fiscal year by \$15,219,248.
- > Net assets increased by a total of \$522,386, or by approximately 3.4% of last year's total net assets of \$ 15,172,979.
- > Net Assets for the Business-Type Activities – Enterprise Funds increased by \$124,696 and net assets for Governmental-Type Activities – Internal Service Fund (Equipment Fund) increased by \$68,609 during the fiscal year.
- > The total fund balance of the Governmental Funds increased by \$479,762. Of this total, the City's General Fund showed a decrease of \$25,773, while the Other Governmental Funds showed an increase of \$505,535. This large increase is due in part to an Operating Transfer In of \$427,807.
- > Appropriation Transfer Out support from the General Fund to Enterprise Funds decreased by \$31,000.

FINANCIAL STATEMENTS OVERVIEW

This Management Discussion and Analysis serves to introduce to the reader the City of Harbor Beach's essential financial statements. These financial statements consist of three components, as follows:

- > **Government-wide financial statements**
- > **Fund financial statements**
- > **Notes to the financial statements**

The above financial information will provide the reader with a general understanding of the City's current financial condition. Also, this report contains supplementary information in addition to the basic financial statements which provides a more detailed understanding of the City's finances.

MANAGEMENT'S DISCUSSION & ANALYSIS

Government-Wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the City's finances, similar to private sector businesses.

The **Statement of Net Assets** presents information on all of the assets and liabilities of the City, with the difference between the two identified as net assets. Over a given period of time, increases or decreases in net assets can serve as a useful indicator of improving or declining financial position of the City.

The **Statement of Activities** shows changes in net assets that occurred during the most recent fiscal year. These changes were recorded on an accrual basis, which distinguishes between the time when a financial transaction occurs and when payment is actually made. An example of accrual accounting is when debt interest payments are scheduled between the fiscal year end. The Statement of Activities will show additional interest expense for the time period between the last interest payment and the end of the fiscal year as an accrual.

The Government-Wide Financial Statements, in addition to the Statement of Activities, is broken down into two Activities: Governmental Activities and Business Type Activities. Governmental activities are primarily supported through tax and intergovernmental revenue. Business-type activities are primarily supported through user fees and charges.

Governmental Activities for the City of Harbor Beach include general governmental functions, such as Financial Administration (City Council and Administrative Staff), General Administration (Major and Local Street and Sidewalk Maintenance and Public Improvements) Planning, Police, Property Assessment and Sanitation. Business-type Activities include Sewer, Water, and Parks and Recreation.

Activities not included in this Report are the Harbor Beach Area Fire Department and the Eastern Huron Ambulance Service. Although the City contributes financially to both entities and has representation on their respective Boards, the City has no legislative control over their financial activity.

The Government-wide Financial Statements are found as listed in the table of contents.

Fund Financial Statements

A fund is a set of closely related accounts that are used to maintain control over resources that have been segregated for specific activities or purposes. The City of Harbor Beach uses fund accounting to demonstrate compliance with legal financial requirements, like all state and local governments. All City Funds can be categorized as either governmental or proprietary funds.

MANAGEMENT'S DISCUSSION & ANALYSIS

Fund Financial Statements (continued)

Governmental Funds account for essentially the same activities as the Governmental Activities in the Government-wide financial statements, but with a narrower focus. Governmental Funds concentrate on near-term inflows and outflows of financial resources and the balances of spendable resources available to the government at the end of the fiscal year. This information can be useful in evaluating the government's short-term financing requirements.

Comparing similar information presented in the Government-wide statements for the Governmental Activities with that presented in Governmental Funds statements can provide useful information because of the different focus of the two approaches. With the long-term focus of the Government-wide statements, a reader may be able to better understand the long-term effects of the near term financing decisions. To aid in the comparison, both the Governmental Fund balance sheet and the Governmental Fund statement of revenues, expenditures and changes in fund balance show a reconciliation between the Governmental Funds statements and the Governmental Activities in the Government-wide statements.

The City of Harbor Beach uses two different individual Governmental Funds. Of these two, information is shown separately for the General Fund and for the Other Governmental Funds. There are also two non-major funds identified as the Major Street and Trunkline Fund and the Local Street Fund. These are combined into a Special Revenue category. The City adopts an annual appropriated budget for all its Governmental Funds.

The basic governmental fund financial statements can be found as listed in the table of contents.

Proprietary Funds include enterprise funds and an internal service fund. Enterprise Funds are used to report any activity for which a fee is charged to external users for goods or services. The Internal Service Fund is used to report activities that provide goods or services to other funds or departments of the City.

The Enterprise Funds maintained by the City of Harbor Beach include water, sewer, and parks and recreation. The City uses the Internal Service Fund to account for vehicles and equipment activities. Because they charge fees and charges to outside users of their systems, the Enterprise Funds are included in the Business-type Activities column of the government-wide financial statements. The Internal Service Fund, which accounts for equipment and vehicles that support City functions, is included under the Governmental Activities column.

MANAGEMENT'S DISCUSSION & ANALYSIS

Proprietary Funds present the same information as in government-wide statements, except in more detail. The fund statements for proprietary funds provide separate information for the Water, Sewer, and Parks and Recreation funds, which are considered to be major funds of the City of Harbor Beach.

The basic proprietary fund financial statements can be found as listed in the table of contents.

Notes to the Financial Statements contain additional financial information to give the reader a complete understanding of the information contained in the government-wide and fund financial statements. Although these Notes provide detailed explanation and information related to the financial statements, this information is typically easy for the reader to follow. Notes to the Financial Statements are located after the financial statements as listed in the table of contents.

OTHER INFORMATION

The combining statements referred to earlier in connection with non-major governmental funds are presented immediately following the Notes to the Financial Statements. Combining and individual fund statements and schedules are listed in the table of contents.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

CITY OF HARBOR BEACH'S NET ASSETS

	Governmental Activities	Business Type Activities	June 30, 2005 Total	June 30, 2004 Total
Current assets	\$ 2,082,741	\$ 702,630	\$ 2,785,371	\$ 2,668,477
Capital assets	7,532,964	11,275,041	18,808,005	19,103,460
Restricted and other assets	411,635	1,075,930	1,487,565	1,708,704
Total assets	<u>\$10,027,340</u>	<u>\$13,053,601</u>	<u>\$23,080,941</u>	<u>\$23,480,641</u>
Current liabilities	\$ 99,911	\$ 239,855	\$ 339,766	\$ 1,116,960
Long-term liabilities	1,201,554	6,320,372	7,521,926	7,190,701
Total liabilities	<u>\$1,301,465</u>	<u>\$ 6,560,227</u>	<u>\$ 7,861,691</u>	<u>\$ 8,307,661</u>
Net assets:				
Invested in capital assets, net of related debt	\$6,803,238	\$ 4,853,049	\$11,656,287	\$12,030,079
Restricted	411,635	988,836	1,400,471	678,873
Unrestricted	1,511,001	651,487	2,162,488	2,464,027
Total net assets	<u>\$8,725,875</u>	<u>\$ 6,493,372</u>	<u>\$15,219,248</u>	<u>\$15,172,979</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS

As shown in the Statement of Net Assets provided above, the largest portion, by far, of the Net Assets of the City of Harbor Beach is its investment in capital assets. The seventy-six and six tenths percent (76.6%) of total net assets represents the City's investment in land and land improvements; curb, gutter and sidewalk; roads and storm drains; water and sewer lines; streetlights and signals, buildings, and machinery and equipment, less any related outstanding debt that was used to acquire these assets. The City of Harbor Beach uses these capital assets to provide essential services to citizens who live, work or visit the City. These assets, by design, are not available for future spending. Additionally, even though these capital assets are reported net of any related debt, resources needed to repay this debt must come from other sources, as these assets cannot be used to satisfy their related obligations.

Of the remaining Net Assets of the City, nine and two tenths percent (9.2%) are subject to external restrictions on how they may be expended (restricted assets). The balance of Net Assets, which total fourteen and two tenths percent (14.2%) can be used to meet the City's ongoing obligations to its creditors and citizens (unrestricted assets).

ACTIVITIES, GOVERNMENTAL AND BUSINESS-TYPE

Net assets in Governmental Activities increased by \$397,689 for the year ended June 30, 2005. This amount is fairly significant as it comprises about four and five tenths of a percent (4.5%) of beginning Net assets for Governmental Activities, which was \$ 8,804,303.

Net assets for Business-type Activities increased by \$124,696 for the year ended June 30, 2005. This amount is not significant as it comprises only one and nine tenths percent (1.9%) of the beginning Net assets for Business-type Activities, which was \$ 6,368,676. However, it is significant as it shows an increase this year, rather than a significant decrease of \$420,327 from the previous year. The increase is due to increases in user fees to support water and sewer service and operating and capital contributions received during the current fiscal year. The City Council has adopted a Resolution calling for an annual two and one-half percent (2.5%) increase in water rates and a three and one-half percent (3.5%) increase in sewer rates. In addition, the City historically has not funded depreciation, and the reader needs to take this into account when analyzing Business-type activities, as depreciation is a significant portion of expenses.

MANAGEMENT'S DISCUSSION AND ANALYSIS

CITY OF HARBOR BEACH'S CHANGES IN NET ASSETS

For the year ended June 30, 2005

	<u>Govern- mental Activities</u>	<u>Business Type Activities</u>	<u>June 30, 2005 Total</u>	<u>June 30, 2004 Total</u>
Revenues:				
Program revenues:				
Charges for services	\$ 112,801	\$1,654,783	\$1,767,584	\$1,630,364
Operating grants and contributions		618,666	618,666	
Capital grants and contributions		275,000	275,000	
General revenues:				
Property taxes	1,106,410	311,451	1,417,861	1,370,635
State shared revenue	390,129		390,129	405,845
Unrestricted investment earnings	41,987	24,082	66,069	62,822
Miscellaneous	19,450	20,779	40,229	43,387
Gain (Loss) on sale of capital assets		(1,286)	(1,286)	13,820
Total revenue	<u>1,670,777</u>	<u>2,903,475</u>	<u>4,574,252</u>	<u>3,526,873</u>
Expenses:				
General government	761,178		761,178	770,892
Public safety	393,751		393,751	375,427
Highways and public improvements	397,747		397,747	424,491
Sanitation	84,664		84,664	81,837
Interest on long-term debt	29,567		29,567	4,187
Water		923,041	923,041	919,607
Sewer		772,284	772,284	748,102
Water & sewer projects				1,080
Parks and recreation		689,636	689,636	692,883
Total expenses	<u>1,666,906</u>	<u>2,384,961</u>	<u>4,051,868</u>	<u>4,018,506</u>
Change in net assets before transfers	<u>3,871</u>	<u>518,514</u>	<u>522,386</u>	<u>(491,633)</u>
Transfers	<u>393,818</u>	<u>(393,818)</u>	<u>-</u>	<u>-</u>
Change in net assets	<u>397,689</u>	<u>124,696</u>	<u>522,386</u>	<u>(491,633)</u>
Net assets – Beginning	8,804,303	6,368,676	15,172,979	15,664,612
Prior Period Adjustment	<u>(476,117)</u>		<u>(476,117)</u>	
Net assets – Ending	<u>\$8,725,875</u>	<u>\$6,493,372</u>	<u>\$15,219,248</u>	<u>\$15,172,979</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL ANALYSIS OF CITY OF HARBOR BEACH'S FUNDS

The City of Harbor Beach's governmental funds provide information on the short-term resource inflows and outflows and account balances at the end of the fiscal year. The total fund balance is a measure of total available resources and the unreserved portion of this total is a measure of the available spendable resources as of June 30, 2005.

For the year ended June 30, 2005, the City's governmental funds reported a combined fund balance amount of \$1,877,658, an increase of \$479,762 from June 30, 2004.

The General Fund is the main operating fund for the City. As of June 30, 2005, the Fund Balance in the General Fund was \$ 914,729. At the start of the fiscal year on July 1, 2004, the Fund Balance was \$940,502, resulting in a decrease in fund balance of \$25,773. This is due to continued appropriation transfer out of \$25,000 to other funds. This amount has decreased significantly over the last two fiscal years. Further, it is important to note that revenue from Other Financing Sources decreased this fiscal year, from \$469,000 last fiscal year to \$216,849 this fiscal year. It is also important to note that revenue in the General Fund has remained virtually the same from the previous fiscal year (less than \$2,000 increase) and expenditures decreased by about \$173,000.

The City's Proprietary Funds provide the same type of information found in the government-wide financial statements, but in more detail. Total Net Assets of Business-type Activities were \$6,493,372 and for the Internal Service Fund were \$793,470.

For Business-type Activities, the following information is provided for the appropriate Enterprise Fund:

<u>FUND</u>	<u>TOTAL ASSETS</u>	<u>TOTAL LIABILITIES</u>	<u>TOTAL NET ASSETS</u>
Sewer	\$ 4,278,267	\$ 1,104,345	\$ 3,173,922
Water	\$ 6,927,294	\$ 5,423,673	\$ 1,503,621
Recreation	\$ 2,003,336	\$ 204,773	\$ 1,798,563

For Governmental Activities, the following information is provided for the Internal Service Fund:

<u>FUND</u>	<u>TOTAL ASSETS</u>	<u>TOTAL LIABILITIES</u>	<u>TOTAL NET ASSETS</u>
Equipment	\$ 795,572	\$ 2,102	\$ 793,470

MANAGEMENT'S DISCUSSION AND ANALYSIS

NON-MAJOR GOVERNMENTAL FUNDS

The City's Non-Major Governmental Funds, which include the Special Revenue Funds of Major Street and Trunkline and Local Street Funds, performed well during the 2004-05 fiscal year. The Major Street and Trunkline Fund showed an increase in fund balance of \$30,451 and the Local Street Fund showed an increase in fund balance of \$64,105. This is due to a decrease in expenditures for the Major Street and Trunkline fund and no construction activity in the Local Street Fund during the fiscal year.

GENERAL FUND BUDGETARY HIGHLIGHTS

The major highlight of the General Fund in the 2004-05 fiscal year was accounting for the M-25 construction project which was done in conjunction with the Michigan Department of Transportation. With this project, there was \$273,225 in general capital outlay expenditures. This was the City's grant match portion of the approximate \$2,820,000 total construction project. This expenditure in general capital outlay was somewhat offset by the \$229,725 in proceeds from bonds for the project. The net result was a decrease in fund balance for the general fund of \$25,773, from \$940,502 in 2003-04 to \$914,729 in 2004-05.

CAPITAL ASSET AND DEBT ADMINISTRATION

The City of Harbor Beach's investment, net of related debt, in capital assets for its governmental and business-type activities combined totaled \$11,656,287. Types of assets in this category are land, land improvements, buildings, machinery and equipment, park and recreation facilities, roads (including curb and gutter, sidewalks and storm drains), street lights, traffic signals, and water and wastewater distribution and collection systems and facilities. The City's investment in capital assets equals over seventy-four percent (74%) of total net assets.

	Governmental Activities	Business Type Activities	June 30, 2005 Total
Land	\$ 2,661,392	\$ 66,530	\$ 2,727,922
Land improvements	150,257		150,257
Buildings	588,627	4,258,057	4,846,684
Office furnishings	11,870		11,870
Equipment	1,180,810	7,046,890	8,227,700
Infrastructure	7,559,585		7,559,585
Water system		4,622,000	4,622,000
Sewer system		1,913,401	1,913,401
Marina improvements		2,652,640	2,652,640
Campground improvements		1,024,514	1,024,514
Construction in progress		291,852	291,852
Accumulated depreciation	<u>(4,619,577)</u>	<u>(10,600,842)</u>	<u>(15,220,419)</u>
Net book value	<u>\$ 7,532,964</u>	<u>\$11,275,042</u>	<u>\$ 18,808,006</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS

CAPITAL ASSET AND DEBT ADMINISTRATION (CONTINUED)

The City of Harbor Beach's debt consists of a 1993 Water Supply and Distribution System Bond (\$3,248,000), a 2000 Public Improvement Bond (\$2,500,000), a 2003 Installment Purchase Agreement (\$ 500,000), a 2004 Capital Improvement Bond (\$ 915,000), and a Harbor Beach Consolidated Drain Assessment (\$439,763). In 2004, the City paid off a 1986 General Obligation Wastewater Disposal Bond issue. Normal payments of principal and interest in accordance with the associated debt service schedules were made on a timely basis during the fiscal year.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

Budget

The current fiscal year budget (2005-06) is at \$ 3,668,000, which is \$201,000 more than the 2004-05 fiscal year budget of \$3,467,000. This increase is due to a slight increase in both revenue and expenditures due to a small increase in property tax and user fee revenue and also a small increase in cost of living expenditures. State Revenue Sharing, once feared to be drastically reduced, has stabilized. The State economy, however, is still sluggish and reeling from a large reduction in manufacturing jobs, in particular, related to the automotive industry.

The current budget for the City plans few major capital expenditures and major projects this year. No major expenditures over \$40,000 are budgeted this year. A sanitary sewer retention basin construction project is slated for construction in 2007-08. This project will be completed under an Administrative Consent Order with the Michigan Department of Environmental Quality to address sanitary sewer overflows and is estimated to cost approximately \$3,500,000. The city is in the process of applying for DEQ Sanitary Sewer Revolving Loan funding, which is currently at a 1.6% interest rate. The City will also be applying for grant funds for this project.

The City plans to continue to encourage economic development in the City by taking advantage of several State and Federal grant and loan programs where applicable. The City recently was awarded a \$10,000 DEQ Coastal Management Grant and will begin a Waterfront Development Plan in January 2006. Examples of other recent grant and loan programs the City has utilized include Community Development Block Grants (CDBG), Urban Land Assembly Loans (ULA), Natural Resources Trust Fund grants, and Land and Water Conservation Fund grants. Economic development programs the City has utilized include establishment of a Local Development Finance Authority (LDFA), a Downtown Development Authority (DDA) and a Brownfield Redevelopment Authority (BRA). The City continues efforts to attract new business and industry to the community to provide an increase in jobs and tax base.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Rates

The City continues to improve its revenue stream for the Water and Sewer Funds. The City has implemented annual increases in the water rate of two and one-half percent (2.5 %) and in the sewer rate of three and one-half percent (3.5%). These rate increases have been in effect now since August 5, 2002. The City continues to pick up new customers in Sand Beach Township and Village of Forestville customers. Both entities are billed at one and one-half times (1 ½) the City residential rate.

The City has also replaced a significant portion of water and sewer main infrastructure over the last few years. In 2001, the City replaced 14,000 lineal feet of water main and 4,000 lineal feet of sewer main. In 2004, the City replaced 6,000 feet of water main and 3,000 feet of sewer main. In 2005, the City replaced 5,000 lineal feet of sewer main. These improvements have reduced maintenance costs of the respective distribution systems.

REQUESTS FOR INFORMATION

This financial report is designed to give the reader a basic understanding of the City of Harbor Beach's finances. Any questions or requests for financial information contained in this report may be obtained by contacting the Finance Officer, City of Harbor Beach, 766 State Street, Harbor Beach, Michigan 48441.

BASIC FINANCIAL STATEMENTS

CITY OF HARBOR BEACH, MICHIGAN

STATEMENT OF NET ASSETS JUNE 30, 2005

	GOVERNMENTAL BUSINESS-TYPE	
	<u>ACTIVITIES</u>	<u>ACTIVITIES</u>
<u>ASSETS</u>		<u>TOTALS</u>
Cash	\$ 1,835,172	\$ 2,437,657
Accounts receivable	25,163	223,561
Taxes receivable	20,574	20,574
Accrued interest	4,049	4,049
Due from other governments	42,484	84,315
Inventory		15,214
Internal balances	155,299	
Nondepreciated capital assets	2,661,392	2,727,922
Capital assets	9,491,149	31,008,651
Less accumulated depreciation	(4,619,577)	(15,220,419)
Construction in progress		291,852
Restricted assets:		
Cash:		
Water and sewer project	411,635	411,635
Wastewater bond reserve		24,326
Wastewater treatment replacement		404,038
Water system revenue bond		71,362
Water bond reserve		275,614
Water equipment replacement		213,496
Operation and maintenance		50,504
Deferred charges		36,590
TOTAL ASSETS	<u>\$ 10,027,340</u>	<u>\$ 23,080,941</u>

CITY OF HARBOR BEACH, MICHIGAN

STATEMENT OF NET ASSETS JUNE 30, 2005

	GOVERNMENTAL		BUSINESS-TYPE		
	<u>ACTIVITIES</u>		<u>ACTIVITIES</u>		<u>TOTALS</u>
<u>LIABILITIES</u>					
Accounts payable	\$	5,425	\$	16,663	\$ 22,088
Accrued payroll and related taxes		20,702		21,990	42,692
Accrued interest payable		10,570		47,099	57,669
Accrued vacation and sick leave		95,280		52,482	147,762
Drain assessment payable		439,763			439,763
Payable from restricted assets:					
Current maturities of debt		63,214		154,103	217,317
Long-term bonds payable		666,511		6,267,890	6,934,401
Total liabilities		<u>1,301,465</u>		<u>6,560,227</u>	<u>7,861,691</u>
<u>NET ASSETS</u>					
Invested in capital assets, net of related debt		6,803,238		4,853,049	11,656,287
Restricted for:					
Debt service				371,302	371,302
Capital projects		411,635		617,534	1,029,169
Unrestricted		1,511,001		651,487	2,162,488
Total net assets		<u>\$ 8,725,875</u>		<u>\$ 6,493,372</u>	<u>\$ 15,219,248</u>

The accompanying notes are an integral part of the financial statements.

CITY OF HARBOR BEACH, MICHIGAN

STATEMENT OF ACTIVITIES JUNE 30, 2005

		PROGRAM REVENUES		NET (EXPENSE) REVENUES & CHANGES IN NET ASSETS	
		OPERATING	CAPITAL	GOVERNMENTAL	BUSINESS-TYPE
		CHARGES FOR	GRANTS AND	ACTIVITIES	ACTIVITIES
		SERVICES	CONTRIBUTIONS	CONTRIBUTIONS	TOTALS
EXPENSES					
Governmental Activities					
General government	\$ 761,178	\$ 3,538		\$ (757,640)	\$ (757,640)
Public safety	393,751			(393,751)	(393,751)
Highways and public improvements	397,747	29,074		(368,673)	(368,673)
Sanitation	84,664	80,190		(4,474)	(4,474)
Interest on long-term debt	29,567			(29,567)	(29,567)
Total governmental activities	1,666,906	112,801	-	(1,554,106)	(1,554,106)
Business-Type Activities					
Water	923,041	760,906	\$ 578,666		416,531
Sewer	772,284	414,357		\$ 275,000	(82,927)
Parks and recreation	689,636	479,520	40,000		(170,116)
Total business-type activities	2,384,961	1,654,783	618,666	-	163,488
Total Government	\$ 4,051,867	\$ 1,767,584	\$ 618,666	(1,554,106)	(1,390,617)
				311,451	1,417,862
				390,129	390,129
				24,082	66,069
				20,779	40,229
				(1,286)	(1,286)
				(393,818)	-
				(38,792)	1,913,003
				124,696	522,386
				6,368,676	15,172,979
				(476,117)	(476,117)
				\$ 6,493,372	\$ 15,219,248
				1,106,410	1,106,410
				390,129	390,129
				41,987	41,987
				19,450	19,450
				-	-
				393,818	393,818
				1,951,794	1,951,794
				397,689	397,689
				8,804,303	8,804,303
				(476,117)	(476,117)
				\$ 8,725,875	\$ 8,725,875
				General Revenue:	
				Property taxes	
				State shared revenues	
				Unrestricted investment earnings	
				Miscellaneous	
				(Loss) on sale of capital assets	
				Transfers - net	
				Total general revenues and transfers	
				Change in net assets	
				Net assets - beginning	
				Prior period adjustment	
				Net assets - ending	

The accompanying notes are an integral part of the financial statements.

CITY OF HARBOR BEACH, MICHIGAN
BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2005

	<u>GENERAL</u>	<u>OTHER NONMAJOR GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
<u>ASSETS</u>			
Cash	\$ 733,781	\$ 923,640	\$ 1,657,421
Accounts receivable	25,165		25,165
Accrued interest	4,049		4,049
Due from other funds	82,000		82,000
Due from other governments	2,078	40,406	42,484
Note receivable - Other funds	90,564		90,564
TOTAL ASSETS	<u>\$ 937,637</u>	<u>\$ 964,046</u>	<u>\$ 1,901,683</u>
<u>LIABILITIES AND FUND BALANCES</u>			
Liabilities:			
Accounts payable	\$ 3,847		\$ 3,847
Accrued payroll and related taxes	19,061	\$ 1,117	20,178
Total liabilities	<u>22,908</u>	<u>1,117</u>	<u>24,025</u>
Fund balances:			
Unreserved, reported in:			
General Fund	914,729		914,729
Special Revenue Funds		551,294	551,294
Capital Projects		411,635	411,635
Total fund balances	<u>914,729</u>	<u>962,929</u>	<u>1,877,658</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 937,637</u>	<u>\$ 964,046</u>	<u>\$ 1,901,683</u>

The accompanying notes are an integral part of the financial statements.

CITY OF HARBOR BEACH, MICHIGAN

**RECONCILIATION OF GOVERNMENTAL FUND BALANCES
TO GOVERNMENTAL ACTIVITIES NET ASSETS
JUNE 30, 2005**

Total governmental fund balances	\$ 1,877,658
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets used in governmental activities are not financial resources and therefore, are not reported in the funds. The cost of the assets is \$12,152,541 less the accumulated depreciation of \$4,619,577.	7,532,964
Interest on general obligation and lease revenue bonds are not accrued in governmental funds but rather is recognized as an expenditure when due.	(10,570)
Delinquent taxes receivable are not current financial resources for the governmental fund.	20,574
Internal service fund is not included in the governmental funds.	570,018
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the funds.	(1,264,768)
Net assets - governmental activities	<u>\$ 8,725,875</u>

CITY OF HARBOR BEACH, MICHIGAN

**STATEMENT OF REVENUE, EXPENDITURES AND CHANGE IN FUND BALANCES
GOVERNMENTAL FUNDS
YEAR ENDED JUNE 30, 2005**

	<u>GENERAL</u>	<u>OTHER NONMAJOR GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
REVENUE:			
Taxes	\$ 1,017,750		\$ 1,017,750
Licenses and permits	2,775		2,775
Intergovernmental	220,301	\$ 237,914	458,215
Charges for services	162,728		162,728
Fines and forfeitures	7,842		7,842
Miscellaneous	38,971	29,930	68,901
TOTAL REVENUE	<u>1,450,367</u>	<u>267,844</u>	<u>1,718,211</u>
EXPENDITURES:			
Current:			
Legislative	11,946		11,946
Elections	4,192		4,192
Financial and administration	274,396	6,650	281,046
General	515,547		515,547
Police department	318,815		318,815
Planning	7,803		7,803
Street lighting	56,461		56,461
Sanitation	83,214		83,214
Streets		162,353	162,353
Capital outlay	315,567		315,567
Debt service:			
Principal	54,317		54,317
Interest	50,731		50,731
TOTAL EXPENDITURES	<u>1,692,989</u>	<u>169,003</u>	<u>1,861,992</u>
EXCESS OF REVENUE OVER (UNDER) EXPENDITURES	<u>(242,622)</u>	<u>98,841</u>	<u>(143,781)</u>
OTHER FINANCING SOURCES (USES):			
Proceeds from bonds	229,725		229,725
Operating transfers in	12,124	427,807	439,931
Operating transfers (out)	(25,000)	(21,113)	(46,113)
TOTAL OTHER FINANCING SOURCES	<u>216,849</u>	<u>406,694</u>	<u>623,543</u>
EXCESS OF REVENUE AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	<u>(25,773)</u>	<u>505,535</u>	<u>479,762</u>
FUND BALANCE - JULY 1	940,502	457,394	1,397,896
FUND BALANCE - JUNE 30	<u>\$ 914,729</u>	<u>\$ 962,929</u>	<u>\$ 1,877,658</u>

CITY OF HARBOR BEACH, MICHIGAN

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO
THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2005**

Net change in fund balances - governmental funds **\$ 479,762**

Amounts reported for governmental activities in the statement of activities
are different because:

Governmental funds report capital outlays as expenditures. However, in the *Statement of Activities*, assets with an initial, individual cost of more than \$1,000 are capitalized and the cost is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.

Capital outlays	\$ 342,414	
Depreciation expense	<u>(320,569)</u>	
		21,845

Some expenses reported in the *Statement of Activities* do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds. (7,082)

The net revenue of certain activities of internal service fund is reported with governmental activities. 57,997

Delinquent property taxes are not considered "available" revenues and are not recorded in the governmental funds. 20,574

Bond proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the Statement of Net Assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets and does not affect the Statement of Activities. In the current period, these amounts are:

Bond repayments	54,317	
Bond proceeds, net discount, and issuance costs	<u>(229,725)</u>	
Net effect		(175,408)

Change in net assets of governmental activities **\$ 397,688**

The accompanying notes are an integral
part of the financial statements.

CITY OF HARBOR BEACH, MICHIGAN
STATEMENT OF NET ASSETS - PROPRIETARY FUNDS
JUNE 30, 2005

	<u>BUSINESS-TYPE ACTIVITIES - ENTERPRISE FUNDS</u>				<u>GOVERNMENTAL ACTIVITIES- INTERNAL SERVICE FUND</u>
	<u>SEWER</u>	<u>WATER</u>	<u>RECREATION</u>	<u>TOTALS</u>	
ASSETS					
Current assets:					
Cash	\$ 332,122	\$ 222,860	\$ 47,703	\$ 602,485	\$ 589,385
Accounts receivable	72,438	125,960		198,396	
Due from other governments			41,831	41,831	
Inventory			15,214	15,214	
Total current assets	404,558	348,820	104,748	857,926	589,385
Noncurrent assets:					
Capital assets	7,288,722	9,050,735	5,286,575	21,584,032	1,044,288
Less accumulated depreciation	(4,154,067)	(3,078,788)	(3,387,987)	(10,600,842)	(838,111)
Construction in progress	291,852			291,852	
Deferred charges	18,661	17,929		36,590	
Total noncurrent assets	3,423,168	5,989,876	1,898,588	11,311,632	206,187
Restricted assets:					
Cash:					
Wastewater treatment replacement	404,038			404,038	
Wastewater bond reserve	24,326			24,326	
Water system revenue bond		71,362		71,362	
Water bond reserve		275,814		275,814	
Water equipment replacement		213,498		213,498	
Operation and maintenance	22,177	28,326		50,504	
Total restricted assets	450,541	588,798		1,039,339	
TOTAL ASSETS	\$ 4,278,267	\$ 6,927,294	\$ 2,003,336	\$13,208,897	\$ 795,572
LIABILITIES					
Current liabilities:					
Accounts payable	\$ 3,952	\$ 1,620	\$ 11,091	\$ 16,663	\$ 1,578
Due to other funds			82,000	82,000	
Notes payable-Other funds			22,450	22,450	
Accrued payroll and related taxes	4,748	7,661	9,581	21,990	524
Accrued interest payable	8,094	35,026	3,979	47,099	
Accrued vacation and sick leave	18,098	26,826	7,558	52,482	
Current maturities of debt	29,950	124,153		154,103	
Total current liabilities	64,842	195,286	138,659	396,787	2,102
Noncurrent liabilities:					
Long-term bonds payable	1,039,503	5,228,387		6,267,890	
Notes payable - other funds			68,114	68,114	
Total noncurrent liabilities	1,039,503	5,228,387	68,114	6,336,004	
Total liabilities	1,104,345	5,423,673	204,773	6,732,791	2,102
NET ASSETS					
Invested in capital assets, net of related debt	2,335,054	619,407	1,898,588	4,853,049	206,187
Restricted for:					
Debt service	24,326	346,976		371,302	
Capital projects	404,038	213,498		617,534	
Unrestricted	470,504	323,742	(100,024)	634,222	587,283
Total net assets	\$ 3,173,922	\$ 1,503,621	\$ 1,798,564	6,476,107	\$ 793,470
Adjustment to reflect the consolidation of Internal Service Fund activities related to enterprise funds				17,265	
Net assets of business-type activities				\$ 6,493,372	

The accompanying notes are an integral part of the financial statements.

CITY OF HARBOR BEACH, MICHIGAN

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET
ASSETS - PROPRIETARY FUNDS
YEAR ENDED JUNE 30, 2005**

	BUSINESS-TYPE ACTIVITIES - ENTERPRISE FUNDS				GOVERNMENTAL ACTIVITIES- INTERNAL SERVICE FUND
	SEWER	WATER SUPPLY	RECREATION	TOTALS	
OPERATING REVENUE:					
Charges for services	\$ 412,457	\$ 688,554	\$ 318,593	\$ 1,419,604	\$ 156,047
Permits	1,900	4,100		6,000	
Sale of materials and labor		8,252	160,927	169,179	
Fire hydrant rental		60,000		60,000	
TOTAL OPERATING REVENUE	414,357	760,906	479,520	1,654,783	156,047
OPERATING EXPENSES:					
Salaries	154,307	173,178	151,219	478,704	9,163
Administrative cost	30,000	30,000	15,000	75,000	1,000
Fringe benefits	68,278	82,055	39,033	189,366	4,378
Cost of merchandise & petroleum sold			120,413	120,413	
Supplies	6,229	7,388	30,689	44,306	7,566
Office expense		483	135	618	
Postage	658		968	1,626	
Clothing	296			296	
Chemicals	20,055	25,350		45,405	
Professional services	4,586	8,916	2,200	13,712	1,230
Contracted services	65,953	1,148	4,468	71,569	
Event charges			2,005	2,005	
Special event expenses			10,650	10,650	
Community promotion			3,581	3,581	
Sanctioning fees			1,698	1,698	
Umpire fees			1,540	1,540	
Printing and publishing			1,297	1,297	
Telephone	1,039	602	3,142	4,783	853
Transportation	1,155	391	484	2,030	15,096
Insurance	4,792	5,515	5,822	16,129	5,112
Utilities	61,470	60,795	72,752	195,017	
Building repairs		42		42	
Equipment maintenance	7,574	2,692	34,054	44,320	3,012
Maintenance of mains	3,555	8,917		10,472	
Repairs and maintenance	1,860	5,915		7,575	
Equipment rental	7,736	12,900	7,518	28,154	
Penalties and fines	500			500	
Licenses and fees	1,950		200	2,150	
Sales tax			8,342	8,342	
Diesel tax			3,563	3,563	
Education and training	1,037	300		1,337	
Dues and subscriptions	100		2,012	2,112	
Depreciation	275,389	293,631	160,353	729,373	53,823
Amortization	4,274	1,195		5,469	
Bank charges - Credit cards			5,855	5,855	
TOTAL OPERATING EXPENSES	722,603	717,413	688,993	2,129,009	101,231
OPERATING INCOME (LOSS)	(308,246)	43,493	(209,472)	(474,226)	54,816
NONOPERATING REVENUE (EXPENSES):					
Interest income	11,082	12,611	389	24,082	10,793
Fines and forfeitures	2,000			2,000	
Gain (loss) on sale of asset	556		(1,842)	(1,286)	3,000
Property tax levy	127,484	183,967		311,451	
Contributions	275,000	578,666	18,774	872,439	
Grant income			40,000	40,000	
Interest expense			(3,474)	(3,474)	

(Continued)

CITY OF HARBOR BEACH, MICHIGAN

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET
ASSETS - PROPRIETARY FUNDS
YEAR ENDED JUNE 30, 2005**

	BUSINESS-TYPE ACTIVITIES - ENTERPRISE FUNDS				GOVERNMENTAL ACTIVITIES- INTERNAL SERVICE FUND
	SEWER	WATER SUPPLY	RECREATION	TOTALS	
NONOPERATING REVENUE (EXPENSES): (CONTINUED)					
Bond interest expense	(52,458)	(210,188)		(262,644)	
Paying agent fees	(141)	(302)		(443)	
TOTAL NONOPERATING REVENUE (EXPENSES)	363,525	584,754	53,847	982,126	13,793
INCOME (LOSS) BEFORE OPERATING TRANSFERS	55,279	608,247	(155,625)	507,900	68,609
OTHER FINANCING SOURCES (USES):					
Operating transfers in	8,989		25,000	33,989	
Operating transfers (out)		(427,807)		(427,807)	
TOTAL OTHER FINANCING SOURCES (USES):	8,989	(427,807)	25,000	(393,818)	
CHANGE IN NET ASSETS	64,268	180,440	(130,625)	114,082	68,609
TOTAL NET ASSETS - BEGINNING	3,109,654	1,323,181	1,929,188		724,861
TOTAL NET ASSETS - ENDING	\$ 3,173,922	\$ 1,503,621	\$ 1,798,563		\$ 793,470
Adjustment to reflect the consolidation of Internal Service Fund activities related to enterprise funds				10,612	
Changes in net assets of business-type activities				\$ 124,694	

CITY OF HARBOR BEACH, MICHIGAN

**STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
YEAR ENDED JUNE 30, 2005**

	<u>BUSINESS-TYPE ACTIVITIES - ENTERPRISE FUNDS</u>				<u>GOVERNMENTAL ACTIVITIES - INTERNAL SERVICE FUND</u>
	<u>SEWER</u>	<u>WATER SUPPLY</u>	<u>RECREATION</u>	<u>TOTALS</u>	
CASH FLOWS FROM OPERATING ACTIVITIES:					
Receipts from customers	\$ 408,876	\$ 769,911	\$ 479,519	\$ 1,658,306	\$ 156,047
Receipts from interfund services					(6,411)
Payments to suppliers of goods and services	(187,127)	(169,027)	(317,221)	(673,375)	(1,000)
Payments to interfund services	(37,736)	(42,900)	(22,518)	(103,154)	(9,163)
Payments to employees	(154,307)	(173,178)	(151,219)	(478,704)	(4,376)
Payments for fringe benefits	(68,278)	(82,055)	(39,033)	(189,366)	
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u>(38,573)</u>	<u>302,751</u>	<u>(50,472)</u>	<u>213,706</u>	<u>135,097</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:					
Operating transfer in	8,989		25,000	33,989	
Operating transfer out		(427,807)		(427,807)	
NET CASH PROVIDED (USED) BY NONCAPITAL FINANCING ACTIVITIES	<u>8,989</u>	<u>(427,807)</u>	<u>25,000</u>	<u>(393,818)</u>	<u>-</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:					
Acquisition of fixed assets	(190,046)	(549,844)	(139,409)	(879,299)	(7,600)
Proceeds from sale of asset	556		13,830	14,386	3,000
Fines and forfeitures	2,000			2,000	
Increase in construction in progress	(275,052)			(275,052)	
Bond principal payment	(28,038)	(117,623)		(145,661)	
Interest and fees paid on bonds	(52,783)	(211,220)		(264,003)	
Interest paid			(99)	(99)	
Property tax levy received	127,484	183,967		311,451	

CITY OF HARBOR BEACH, MICHIGAN

**STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
YEAR ENDED JUNE 30, 2005**

	<u>BUSINESS-TYPE ACTIVITIES - ENTERPRISE FUNDS</u>				<u>GOVERNMENTAL ACTIVITIES - INTERNAL SERVICE FUND</u>
	<u>SEWER</u>	<u>WATER SUPPLY</u>	<u>RECREATION</u>	<u>TOTALS</u>	
Proceeds from bonds	174,867	524,787		699,654	
Contributions from state			18,774	18,774	
Contributions from customers	275,000	578,666		853,666	
Grant income			40,000	40,000	
NET CASH PROVIDED (USED) BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>33,988</u>	<u>408,733</u>	<u>(66,904)</u>	<u>375,817</u>	<u>(4,600)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:					
Interest on investments	11,085	12,611	389	24,085	10,792
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>11,085</u>	<u>12,611</u>	<u>389</u>	<u>24,085</u>	<u>10,792</u>
NET INCREASE (DECREASE) IN CASH AND RESTRICTED CASH	<u>15,489</u>	<u>296,288</u>	<u>(91,987)</u>	<u>219,790</u>	<u>141,289</u>
CASH AND RESTRICTED CASH - BEGINNING OF THE YEAR	767,174	515,170	139,691	1,422,035	448,096
CASH AND RESTRICTED CASH - END OF THE YEAR	<u>\$ 782,663</u>	<u>\$ 811,458</u>	<u>\$ 47,704</u>	<u>\$ 1,641,825</u>	<u>\$ 589,385</u>
Cash Reconciliation:					
Cash	332,122	222,660	47,703	602,485	589,385
Restricted cash	450,541	588,798		1,039,339	
Total	<u>\$ 782,663</u>	<u>\$ 811,458</u>	<u>\$ 47,703</u>	<u>\$ 1,641,824</u>	<u>\$ 589,385</u>

CITY OF HARBOR BEACH, MICHIGAN

**STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
YEAR ENDED JUNE 30, 2005**

	<u>BUSINESS-TYPE ACTIVITIES - ENTERPRISE FUNDS</u>				<u>GOVERNMENTAL ACTIVITIES - INTERNAL SERVICE FUND</u>
	<u>SEWER</u>	<u>WATER SUPPLY</u>	<u>RECREATION</u>	<u>TOTALS</u>	
Reconciliation of operating income (loss) loss to net cash provided (used) by operating activities:					
Operating income (loss)	\$ (308,246)	\$ 43,493	\$ (209,472)	\$ (474,225)	\$ 54,816
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:					
Depreciation	275,389	293,631	160,353	729,373	53,823
Amortization	4,274	1,195		5,469	
(Increase) decrease in current assets:					
Accounts receivable	(5,481)	(29,606)		(35,087)	26,696
Due from other funds	1,500			1,500	
Due from other governments			(39,188)	(39,188)	
Inventory			(5,208)	(5,208)	
Increase (decrease) in current liabilities:					
Accounts payable	(6,093)	(9,692)	(16,317)	(32,102)	157
Accrued payroll and related taxes	(1,468)	4,667	533	3,732	(395)
Accrued vacation and sick leave	1,552	563	1,827	3,942	
Due to other funds		(1,500)	57,000	55,500	
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u>\$ (38,573)</u>	<u>\$ 302,751</u>	<u>\$ (50,472)</u>	<u>\$ 213,706</u>	<u>\$ 135,097</u>

The accompanying notes are an integral part of the financial statements.

CITY OF HARBOR BEACH, MICHIGAN

**STATEMENT OF NET ASSETS - FIDUCIARY FUND
JUNE 30, 2005**

	FIDUCIARY FUND TYPE EXPENDABLE TRUST
<u>ASSETS</u>	
Cash	\$ 107,635
Accrued Interest receivable	10
TOTAL ASSETS	<u>\$ 107,645</u>
<u>NET ASSETS</u>	
Reserved for sick leave	\$ 107,645
TOTAL NET ASSETS	<u>\$ 107,645</u>

CITY OF HARBOR BEACH, MICHIGAN

STATEMENT OF ACTIVITIES

FIDUCIARY FUND

YEAR ENDED JUNE 30, 2005

	<u>EXPENDABLE TRUST</u>
REVENUE:	
Employer contribution	\$ 3,815
Interest income	<u>620</u>
TOTAL REVENUE	4,435
 EXPENDITURES:	
Sick leave payments	<u>748</u>
 CHANGE IN NET ASSETS	3,687
 NET ASSETS - JULY 1	103,958
 NET ASSETS - JUNE 30	<u><u>\$ 107,645</u></u>

The accompanying notes are an integral
part of the financial statements.

CITY OF HARBOR BEACH, MICHIGAN

NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2005

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The City of Harbor Beach operates a Council-Mayor form of government under provisions of a revised charter dated May 18, 1965, and provides the following services as authorized by its charter: public safety, (police, fire and inspection), highways and streets, sanitation, water, parks and recreation, public improvements, planning and zoning, and general administration.

The City's financial statements are prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (Statements and Interpretations). Governments are also required to follow the pronouncements of the Financial Accounting Standards Board (FASB) issued through November 30, 1989 (when applicable) that do not conflict with or contradict GASB pronouncements. The accounting policies of the City conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The more significant accounting policies established in GAAP and used by the City are discussed below.

In June 1999, GASB unanimously approved Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. Certain of the significant changes in the Statement include the following:

- The financial statements include:
 - A Management Discussion and Analysis (MD&A) section providing an analysis of the City's overall financial position and results of operations.
 - Financial statements prepared using full accrual accounting for all of the City's activities, including infrastructure (roads, bridges, etc.).
- A change in the fund financial statements to focus on the major funds.

These and other changes are reflected in the accompanying financial statements (including notes to financial statements). The city elected to implement the general provisions of the Statement in the year ended June 30, 2004.

REPORTING ENTITY:

In evaluating how to define the City for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in the related GASB 14 pronouncement. The basic-but not the only-criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations, and accountability for fiscal matters. The other criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether the City is able to exercise oversight responsibilities. Based upon the application of these criteria, the following is a brief review of each potential component unit addressed in defining the City's reporting entity.

CITY OF HARBOR BEACH, MICHIGAN

NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2005

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

REPORTING ENTITY: (CONTINUED)

Excluded from the reporting entity:

Harbor Beach Historical Society - This potential component unit is excluded from the reporting entity because the City does not have the ability to exercise influence or control over their daily operations, approve budgets or provide funding.

Harbor Beach Community Fire Protection Association - The Association is a separate entity formed by the City of Harbor Beach, Michigan and the Township of Sand Beach, both are located in Huron County, Michigan. The Association began operating February 1, 1985, under the terms of an interlocal agreement. The purpose of the Association is to provide fire protection to area property owners and residents. The governing body consists of two representatives appointed by each constituent unit. The Association is financed through assessments to the constituent units. The agreement states that the Association will operate on a calendar year and that its books will be audited annually by a certified public accounting firm chosen by the board. The Fire Department is excluded from the reporting entity because the City does not have the ability to exercise influence or control over its daily operations or approve budgets. The assessment to the City of Harbor Beach for the year ended June 30, 2005, amounted to \$47,197.

Harbor Beach Community School District - This potential component unit has a separate elected board and provides services to local residents of the Harbor Beach, Michigan area. The City does not have the ability to exercise influence or control over its daily operations, approve budgets or provide funding.

GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS:

The City's basic financial statements include both government-wide (reporting the City as a whole) and fund financial statements (reporting the City's major funds). Both the government-wide and fund financial statements categorize primary activities as either governmental or business type. The City's police and general administrative services are classified as governmental activities. The City's water, sewer, and parks and recreation are classified as business-type activities.

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the City. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those which are clearly identifiable with specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

CITY OF HARBOR BEACH, MICHIGAN

NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2005

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED) **MEASUREMENT FOCUS, BASIS OF ACCOUNTING, AND FINANCIAL STATEMENT** **PRESENTATION:**

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they become available. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The use of financial resources to acquire capital assets are capitalized as assets in the government-wide financial statements, rather than reported as an expenditure. Proceeds of long-term debt are recorded as a liability in the government-wide financial statements, rather than as an other financing source. Amounts paid to reduce long-term debt of the City are reported as a reduction of the related liability, rather than an expenditure in the government-wide financial statements.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt-service expenditures, as well as expenditures related to claims and judgments, are recorded only when payment is due.

Sales taxes, franchise taxes, and earned but unreimbursed state and federal grants associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Property taxes are measurable as of the date levied (assessed) and are recognized as revenues when they become available. Available means when due, or past due, and received within the current period or collected soon enough thereafter (within 60 days) to be used to pay liabilities of the current period. All other revenues are considered to be measurable and available only when cash is received by the City.

The accounts of the City are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, reserves, fund balance, revenues, and expenditures or expenses as appropriate.

The City reports the following major governmental funds:

General Fund - The General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund.

CITY OF HARBOR BEACH, MICHIGAN

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

MEASUREMENT FOCUS, BASIS OF ACCOUNTING, AND FINANCIAL STATEMENT PRESENTATION: (CONTINUED)

The City reports the following major proprietary funds:

The **Sewer Fund** accounts for the activities of the City's wastewater treatment operations.

The **Water Fund** accounts for the activities of the City's water distribution system.

The **Recreation Fund** provides campground facilities for overnight and seasonal campers and recreational vehicles, sales of marine fuels, seasonal and overnight boat docking and boat launching.

Additionally, the City reports the following nonmajor fund types:

Special Revenue Funds - Special Revenue Funds account for resources legally restricted to expenditures for specified current operating purposes and for the enforcement of special services and activities. Accounting and financial reporting for General and Special Revenue Funds are identical. The City accounts for the Major Street and Local Street in special revenue funds.

Capital Project Fund - The Capital Project Fund of the City accounts for the cost of constructing a variety of public works projects and related debt service. Financing is provided by a general obligation bond.

Internal Service Funds - Internal Service Funds are used to account for the financing of goods or services provided by one department or agency to other departments or agencies of the City or to other governments on a cost-reimbursement basis. The Equipment Fund rents equipment to other City funds and departments at an hourly rate determined by the State of Michigan.

Fiduciary Fund Types:

Trust Funds - Trust funds are used to account for assets held by the City in a trustee capacity. The City is in a trustee capacity in relation to the Sick Leave Fund.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments to the General Fund by various enterprise funds for providing administrative and billing services for such funds. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operation. The principal operating revenues of the Utility enterprise funds and the City's Internal Service fund are charges to customers to the system. Operating expenses for enterprise funds and the internal service fund include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

CITY OF HARBOR BEACH, MICHIGAN
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

BUDGETS AND BUDGETARY ACCOUNTING:

The City follows these procedures in establishing the budgetary data reflected in the financial statements.

A. Formal budgetary integration is employed as a management control device during the year for the General Fund and Special Revenue Funds as well as for all Enterprise and Internal Service funds. These budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP).

B. The City Council approves, by ordinance, the total budget appropriations only. The City Finance Officer is authorized to transfer budget amounts between departments within any fund; however, any revisions that alter the total appropriations of any fund must be approved by the City Council. Therefore, the level of budgetary responsibility is by total appropriations; however, for report purposes, this level has been expanded to a functional basis (Legislative, Election, Financial and Administration, General, etc.).

C. Unused appropriations for all of the above annually budgeted funds lapse at the end of the year.

D. The budget amounts shown in the financial statements are the final authorized amounts as revised during the year.

Formal budgetary integration is employed as a management control device during the year for the General Fund, Special Revenue Funds, Enterprise Funds, and the Capital Project Funds. In the General Fund, budgets are adopted at the functional level and budgetary control is exercised at the department level. For Special Revenue Funds, budgets are adopted and control is exercised at the level of total expenditures for each individual fund. For Capital Project Funds, budgets are adopted and control is exercised at the project level.

Annual budgets for the General Fund and all Special Revenue Funds were legally adopted by the City and are prepared on the modified-accrual method of accounting.

RECEIVABLES AND PAYABLES:

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. the current portion of interfund loans) or "advances to/from other funds" (i.e. the noncurrent portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds".

Other receivables at June 30, 2005 consist of property taxes, state road taxes, and billings for user charged services, including trash collections and utility services. Taxes, trash and utility charges are deemed collectible in full.

CITY OF HARBOR BEACH, MICHIGAN
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

PROPERTY TAXES:

Property taxes attach as an enforceable lien on property as of December 31. City taxes are levied on the following December 1 and are payable without penalty through February 14. The City bills and collects its own property taxes and also taxes for the county and school districts within its jurisdiction. Collections and remittances of the county and school taxes are accounted for in the current Tax Agency Fund. City property tax revenues are recognized as revenues in the fiscal year levied to the extent that they are measurable and available. Delinquent taxes are expected to be fully collectible and therefore no allowance for uncollectible taxes is provided.

INVENTORY:

Inventory in the Harbor Authority, a Proprietary Fund, is valued at the lower of cost or market on the first-in first-out method.

CAPITAL ASSETS:

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items) are reported in the applicable governmental or business type activities columns in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$1,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.

Property, plant, and equipment of the primary government is depreciated using the straight line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Infrastructure	15 to 50
Buildings	25 to 50
Office equipment	5 to 15
Machinery and equipment	5 to 20
Vehicles	5 to 8
Improvements other than buildings	20

CITY OF HARBOR BEACH, MICHIGAN

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

CAPITAL ASSETS: (CONTINUED)

Depreciation of capital assets used by governmental funds is charged as an expense against their operations on the Statement of Activities. Accumulated depreciation is reported on the governmental fund Statement of Net Assets. Depreciation expense for the year ended June 30, 2005, was \$320,569. Capital asset acquisitions in the governmental funds totaled \$342,414 for the year ended June 30, 2005. A summary of Governmental Fund capital assets at June 30, 2005, follows:

Land	\$2,661,392
Land improvements	150,257
Buildings	588,627
Office furnishings	11,870
Equipment	136,512
Internal Service Fund assets	1,044,298
Storm sewer	830,645
Roads	4,998,110
Other infrastructure	<u>1,730,830</u>
Total capital assets	12,152,541
Less accumulated depreciation	(4,619,577)
NET GOVERNMENTAL FUND CAPITAL ASSETS	<u>\$7,532,964</u>

Depreciation of capital assets used by business-type funds is charged as an expense against their operations. Accumulated depreciation is reported on business-type fund balance sheets. Depreciation expense for the year ended June 30, 2005, was \$729,373. Capital asset acquisitions in the business-type funds totaled \$879,299 and asset disposals totaled \$24,570 for the year ended June 30, 2005. A summary of Business-Type Fund capital assets at June 30, 2005, follows:

Land	\$ 66,530
Buildings	4,258,057
Water system	4,622,000
Sewer system	1,913,401
Harbor docks	799,646
Harbor and parking lot	1,852,994
Equipment	7,046,890
North Park sites and improvements	<u>1,024,514</u>
Total capital assets	21,584,032
Less accumulated depreciation	(10,600,842)
Construction in progress	<u>291,852</u>
NET BUSINESS-TYPE FUND CAPITAL ASSETS	<u>\$11,275,042</u>

CITY OF HARBOR BEACH, MICHIGAN

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)
CAPITAL ASSETS: (CONTINUED)

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental activities:	
General government	\$ 13,660
Public safety	15,353
Highways and public improvement	290,106
Sanitation	1,450
Total depreciation expense – governmental activities	<u>\$320,569</u>
Business-type activities:	
Sewer	\$275,389
Water	293,631
Parks and recreation	160,353
Total depreciation expense – business-type activities	<u>\$729,373</u>

LONG-TERM OBLIGATIONS

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the statement of net assets. Bond premiums and discounts, as well as issuance costs, are amortized over the life of the bonds using the straight line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

USE OF ESTIMATES:

The process of preparing financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenditures. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

NOTE 2 - BUDGET COMPLIANCE:

During the year ended June 30, 2005, the City incurred expenditures in the following fund which were in excess of the amounts appropriated:

	<u>BUDGET</u>	<u>ACTUAL</u>	<u>VARIANCE</u>
General Fund:			
Capital outlay	\$79,262	\$315,567	\$(236,305)
Debt service	100,738	105,048	(4,310)

CITY OF HARBOR BEACH, MICHIGAN

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 3 - DETAIL NOTES ON ALL FUNDS AND ACCOUNT GROUPS:

A. As of June 30, 2005, the City has a carrying amount of \$3,996,267 of deposits (cash and deposits) in local banks and the bank balance was \$4,156,749. Of the bank balance \$500,000 was covered by the Federal Deposit Insurance Corporation and \$3,656,749 remained uninsured and uncollateralized.

Michigan Compiled Laws Section 129.91, authorizes the City to deposit and invest in the accounts of federally insured banks, credit unions and savings and loan associations; bonds, securities and other obligations of the United States, or an agency or instrumentality of the United States in which the principal and interest is fully guaranteed by the United States, including securities issued or guaranteed by the Government National Mortgage Association; United States government or federal agency obligation repurchase agreements; bankers' acceptance of United States banks; mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan; and commercial paper rated by two standard rating agencies within the three highest classifications, which mature not more than 270 days after the date of purchase, and which involves no more than 50 percent of any one fund. Attorney General's Opinion Number 6168 states that public funds may not be deposited in financial institutions located in states other than Michigan. The City's deposits are in accordance with statutory authority.

B. Property taxes are levied based on the taxable value of property located in the City. Assessed value is established annually and equalized by the State at an estimated 50% of current market value. A comparison of the assessed and taxable property values for the 2004 tax levy is as follows:

	ASSESSED VALUE	TAXABLE VALUE
Real property-Regular roll	\$47,802,000	\$40,666,024
Personal property-Regular roll	9,839,800	9,839,800
TOTAL	\$57,641,800	\$50,505,824

The City is permitted, by charter, to levy up to \$20 (20 mills) per \$1,000 of taxable value for general governmental services including debt service. For the year ended June 30, 2005, the City levied 14.91 mills for general governmental services and 4.57 mills for debt service. Total millage levied was 19.48.

C. The balances of interfund receivables and payables are as follows:

Fund	Interfund Receivable	Fund	Interfund Payable
General	\$ 82,000	Recreation	\$ 82,000
General-Notes Receivable	90,564	Recreation-Notes Payable	90,564
Totals	\$172,564		\$172,564

D. **Construction in Progress** – The construction in progress in the amount of \$291,852 represents engineering fees related to improvements to be made to the Waste Water Treatment Plant to handle additional hydraulic flow from an industrial customer.

CITY OF HARBOR BEACH, MICHIGAN

NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2005

NOTE 3 - DETAIL NOTES ON ALL FUNDS AND ACCOUNT GROUPS: (CONTINUED)

E. Pension Plan

1. Plan Description - The City participates in the Michigan Municipal Employees Retirement System, an agent multiple-employer defined benefit pension plan that covers all full-time employees of the City. The system provides retirement, disability and death benefits to plan members and their beneficiaries. The Michigan Municipal Employees Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to the System at 1134 Municipal Way, Lansing, Michigan 48917.

2. Funding Policy - The obligation to contribute to and maintain the system for these employees was established by negotiation with the City's collective bargaining units and requires a contribution from the employees of 3% of the first \$4,200 of annual compensation and 5% of portions over \$4,200.

3. Annual Pension Cost - For the year ended June 30, 2005, the City's annual pension cost of \$38,794 for the plan was equal to the City's required and actual contribution. The annual required contribution was determined as part of an actuarial valuation at December 31, 2004, using the entry actual age cost method. Significant actuarial assumptions used include (a) an 8% investment rate of return, (b) projected salary increases of 4.5% per year, and (c) 2% per year cost of living adjustments. Both (a) and (b) include an inflation component of 3%. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a four-year period. The unfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis.

Three year trend information:

	<u>Fiscal year ended December 31,</u>		
	<u>2002</u>	<u>2003</u>	<u>2004</u>
Annual pension cost	\$ 40,421	\$ 37,048	\$ 37,976
Percentage of APC contributed	100%	100%	100%
Net pension obligation	-0-	-0-	-0-
Actuarial value of assets	3,491,032	3,753,989	4,042,777
Actuarial Accrued Liability (entry age)	3,695,854	3,469,849	3,986,975
Unfunded (overfunded) AAL	204,822	(284,140)	(55,802)
Funded ratio	94%	108%	101%
Covered payroll	823,133	850,616	889,480
UAAL as a percentage of covered payroll	25%	0%	0%

F. Accumulated Sick Pay - The City allows one day per month sick leave; not to exceed 12 days per year, with unlimited maximum accumulation. All unused sick leave will be paid at one-half the current hourly rate of pay, up to a maximum payment of \$15,000, upon retirement with the City, provided that and conditional to the employee having ten years or more employment with the City. Upon death of the employee, all unused sick leave time will be paid to the employee's beneficiary in accordance with the above mentioned formula. The City has entered into an agreement with union employees whereby the City must deposit into a special group savings account in the City's name, the total accrued unused sick leave on December 31 of each year at one half the employees' current hourly rate. Upon eligible retirement, an employee may withdraw his credited balance including interest. Should an employee exhaust his yearly allotted sick leave, he then may draw one half days wages from his banked sick leave. The City will match the one half day's wages at the employees current rate. The employee may continue to draw until his bank is exhausted or the \$15,000 maximum is reached, whichever comes first. The liability for accumulated unpaid sick leave recorded in the governmental and business-type funds at June 30, 2005, is \$87,442.

(Continued)

CITY OF HARBOR BEACH, MICHIGAN

NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2005

NOTE 3 - DETAIL NOTES ON ALL FUNDS AND ACCOUNT GROUPS: (CONTINUED)

G. Accrued Vacation Pay - The City's policy is to permit employees to accumulate limited amounts of earned, but unused, vacation benefits, which are vested in the employees. A long-term liability of \$60,319 of accrued vacation benefits at June 30, 2005, has been recorded in the governmental and business-type funds, representing the City's commitment to fund such costs from future operations.

H. Unemployment Benefits - The City has elected to be treated as a reimbursing employer for unemployment purposes. Any unemployment benefits paid to City employees by the Michigan unemployment fund must be reimbursed by the City on a dollar for dollar basis. The contingent liability for unemployment benefits is not recognized in the accompanying financial statements. The expense is recognized at the time the City becomes liable to the State of Michigan for unemployment benefits paid.

I. Risk Management - Property, liability and worker's compensation insurance and health and disability benefits are contracted by the City with commercial insurance providers. For the year ended June 30, 2005, there have been no significant reductions in insurance coverage. Settlement amounts have not exceeded insurance coverage for the current year or the three prior years.

NOTE 4 - LONG-TERM DEBT:

The City of Harbor Beach has issued 1993 Water Supply and Distribution System Revenue Bonds to aid in the construction of a new water plant. The bond issue totaled \$4.345 million dollars. Twenty-two and twenty seven-hundredths percent (22.27%) of the issue is guaranteed through payments, by contract with an industrial water user. A surety bond has been issued by an insurance company securing the industrial water user's share of this project. The issue matures on November 1, 2032. The City has also issued 2000 General Obligation Public Improvement Bonds to aid in the replacement of the City's water and sewer lines. The bond issue totaled \$2.75 million dollars. The bond issue will mature on May 1, 2020. The City has also issued 2004 Capital Improvement Bonds. The bond issue totaled \$950,000 and will mature on May 1, 2024. Bonds currently outstanding are as follows:

	<u>JUNE 30,</u> <u>2004</u>	<u>ADDITIONS</u>	<u>RETIREMENTS</u>	<u>JUNE 30,</u> <u>2005</u>	<u>DUE WITHIN</u> <u>ONE YEAR</u>
Governmental activities:					
County drain assessment	\$ 469,080		\$ 29,317	\$ 439,763	\$ 29,317
Installment purchase Agreement	525,000		25,000	500,000	25,000
Total governmental activities	<u>\$994,080</u>		<u>\$ 54,317</u>	<u>\$ 939,763</u>	<u>\$ 54,317</u>
Business-type activities:					
Bonds payable:					
Capital improvement	\$ 950,000		\$ 35,000	\$ 915,000	\$ 35,000
Water supply and distribution	3,308,000		60,000	3,248,000	63,000
Public improvement	2,560,000		60,000	2,500,000	65,000
Total bonds payable – business-type activities	<u>\$6,818,000</u>		<u>\$155,000</u>	<u>\$6,663,000</u>	<u>\$163,000</u>

(Continued)

NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005

NOTE 4 - LONG-TERM DEBT: (CONTINUED)

The long-term debt, principal and interest, maturing in the next five years is as follows:

<u>JUNE 30,</u>	<u>CAPITAL IMPROVEMENT</u>	<u>WATER SUPPLY AND DISTRIBUTION</u>	<u>PUBLIC IMPROVEMENT</u>	<u>TOTAL LONG- TERM DEBT</u>
2006	\$ 76,878	\$ 231,866	\$ 199,744	\$ 508,488
2007	75,652	231,480	206,414	513,546
2008	74,392	231,910	212,568	518,870
2009	78,080	232,130	218,212	528,422
2010	76,520	231,167	228,344	536,031
2011-2015	371,815	1,155,869	1,270,702	2,798,386
2016-2020	363,833	1,152,575	1,518,580	3,034,988
2021-2025	288,643	1,147,854		1,436,497
2026-2030		1,141,339		1,141,339
2031		138,544		138,544
Total	<u>1,405,813</u>	<u>5,894,734</u>	<u>3,854,564</u>	<u>11,155,111</u>
Less interest	<u>490,813</u>	<u>2,646,734</u>	<u>1,354,564</u>	<u>4,492,111</u>
Outstanding principal	<u>\$ 915,000</u>	<u>\$3,248,000</u>	<u>\$2,500,000</u>	<u>\$6,663,000</u>

In 1996, the City approved a resolution that authorized a County Drain Assessment in the amount of \$586,350. The annual principal payments total \$29,317 plus interest at 6%. The assessment matures in 2019. The City has also issued a 2003 Installment Purchase Agreement for the purchase of land. The agreement totaled \$525,000 and will mature on April 1, 2019. The drain assessment and the purchase agreement are recorded in the Governmental Activities. The long-term debt, principal and interest, maturing in the next five years is as follows:

<u>JUNE 30,</u>	<u>INSTALLMENT PURCHASE AGREEMENT</u>	<u>COUNTY DRAIN ASSESSMENT</u>
2006	\$ 40,551	\$57,462
2007	39,754	55,586
2008	43,877	53,710
2009	42,920	51,833
2010	41,963	49,957
2011-2015	223,863	221,640
2016-2019	<u>191,961</u>	<u>174,732</u>
Total	624,889	664,920
Less interest	<u>124,889</u>	<u>225,157</u>
Outstanding principal	<u>\$500,000</u>	<u>\$439,763</u>

NOTE 5 - PRIOR PERIOD ADJUSTMENT:

During the year ended June 30, 2005, an outstanding drain assessment liability was discovered. As of July 1, 2004, the amount of the liability was \$469,080 and the related accrued interest was \$7,036. As a result, net assets of the governmental activities as of July 1, 2004 have been reduced by \$476,117.

REQUIRED SUPPLEMENTAL INFORMATION

CITY OF HARBOR BEACH, MICHIGAN

GENERAL FUND SCHEDULE OF REVENUE, EXPENDITURES AND CHANGE IN FUND BALANCE - BUDGET AND ACTUAL YEAR ENDED JUNE 30, 2005

	<u>ORIGINAL BUDGET</u>	<u>FINAL BUDGET</u>	<u>ACTUAL</u>	<u>VARIANCE WITH FINAL BUDGET - FAVORABLE (UNFAVORABLE)</u>
REVENUE:				
Taxes:				
Current property taxes	\$ 1,012,000	\$ 1,018,000	\$ 1,017,436	\$ (564)
Trailer park taxes	<u>800</u>	<u>300</u>	<u>314</u>	<u>14</u>
Total taxes	<u>1,012,800</u>	<u>1,018,300</u>	<u>1,017,750</u>	<u>(550)</u>
Licenses and permits:				
Building permits	<u>3,000</u>	<u>2,500</u>	<u>2,775</u>	<u>275</u>
Intergovernmental:				
State revenue sharing:				
Sales tax - Constitutional	115,000	122,500	122,712	212
Sales tax - Statutory	80,000	95,000	95,429	429
Liquor license	<u>200</u>	<u>2,000</u>	<u>2,160</u>	<u>160</u>
Total intergovernmental	<u>195,200</u>	<u>219,500</u>	<u>220,301</u>	<u>801</u>
Charges for services:				
Trash pickup collections	83,000	80,000	80,190	190
Charges for fees and services	<u>85,000</u>	<u>82,500</u>	<u>82,538</u>	<u>38</u>
Total charges for services	<u>168,000</u>	<u>162,500</u>	<u>162,728</u>	<u>228</u>
Fines and forfeitures	<u>10,000</u>	<u>7,800</u>	<u>7,842</u>	<u>42</u>
Miscellaneous:				
Interest income	20,000	15,700	19,138	3,438
Sale of assets	20,000			
Contributions	1,000	8,500	8,633	133
Rents and leases	<u>10,000</u>	<u>11,200</u>	<u>11,200</u>	
Total miscellaneous	<u>51,000</u>	<u>35,400</u>	<u>38,971</u>	<u>3,571</u>
TOTAL REVENUE	<u>1,440,000</u>	<u>1,446,000</u>	<u>1,450,367</u>	<u>4,367</u>
EXPENDITURES:				
Legislative:				
Council and mayor salaries	8,000	6,800	6,775	25
Fringe benefits	500	600	549	51
Conferences and workshops	2,500	4,100	4,091	9
Supplies	500	300	270	30
Community promotion	<u>1,500</u>	<u>200</u>	<u>261</u>	<u>(61)</u>
Total legislative	<u>13,000</u>	<u>12,000</u>	<u>11,946</u>	<u>54</u>

(Continued)

CITY OF HARBOR BEACH, MICHIGAN

GENERAL FUND SCHEDULE OF REVENUE, EXPENDITURES AND CHANGE IN FUND BALANCE - BUDGET AND ACTUAL YEAR ENDED JUNE 30, 2005

	ORIGINAL BUDGET	FINAL BUDGET	ACTUAL	VARIANCE WITH FINAL BUDGET - FAVORABLE (UNFAVORABLE)
Elections:				
Salaries	3,000	3,000	2,869	131
Fringe benefits	400	300	213	87
Office supplies	400	500	459	41
Postage	200	200	140	60
Printing and publishing	700	100	100	
Contracted services	300	400	411	(11)
Total elections	5,000	4,500	4,192	308
Financial and administration:				
Salaries	165,000	164,000	163,054	946
Fringe benefits	60,000	69,000	68,521	479
Postage	1,000	800	781	19
Professional services	8,000	4,700	4,637	63
Contracted services	2,500	1,200	1,173	27
Office supplies	1,000	1,200	1,189	11
Telephone	4,000	3,200	3,102	98
Transportation	1,000	1,000	967	33
Conferences and workshops	2,500	4,300	4,297	3
Community promotion	4,000	7,200	7,164	36
Insurance	1,000	700	693	7
Assessor	20,000	18,500	18,081	419
Board of review	2,000	1,000	737	263
Total financial and administration	272,000	276,800	274,396	2,404
General:				
Salaries	115,000	126,500	126,478	22
Fringe benefits	80,000	90,200	90,179	21
Supplies	15,000	15,000	15,379	(379)
Postage	1,000	500	466	34
Clothing	1,500	1,200	1,124	76
Professional services	20,000	11,600	11,580	20
Contracted services	75,000	63,600	63,560	40
Engineering fees	5,000	500	473	27
Transportation		100	4	96
Community promotion	5,000	14,300	14,296	4
Printing & publishing	3,000	2,500	2,352	148
Insurance	40,000	31,600	31,518	82
Utilities	25,000	20,000	20,116	(116)
Repairs and maintenance	8,000	7,200	7,177	23
Equipment rental	40,000	58,500	58,497	3
Dues and subscriptions	1,000	1,000	810	190
Sidewalk maintenance	8,000	11,200	11,174	26
Hydrant rental	60,000	60,000	60,000	
Education	1,000	500	364	136
Total general	503,500	516,000	515,547	453

(Continued)

CITY OF HARBOR BEACH, MICHIGAN

GENERAL FUND SCHEDULE OF REVENUE, EXPENDITURES AND CHANGE IN FUND BALANCE - BUDGET AND ACTUAL YEAR ENDED JUNE 30, 2005

	ORIGINAL BUDGET	FINAL BUDGET	ACTUAL	VARIANCE WITH FINAL BUDGET - FAVORABLE (UNFAVORABLE)
Police department:				
Salaries	210,000	212,500	212,377	123
Fringe benefits	55,000	69,300	69,219	81
Postage	200	200	192	8
Supplies	2,900	3,600	3,545	55
Dues and subscriptions	200	100	238	(138)
Uniforms	1,000			
Cleaning allowance	300	300	255	45
Professional services	7,000	7,500	7,455	45
Telephone	3,400	3,800	3,754	46
Police car maintenance	11,000	10,900	10,326	574
Insurance	12,000	11,500	11,406	94
Education and training	1,000	-	48	(48)
Total police department	304,000	319,700	318,815	885
Planning:				
Salaries	12,000	6,600	6,593	7
Fringe benefits	800	600	512	88
Professional services	2,000			
Postage	200			
Telephone	800			
Supplies and tools	200	500	456	44
Conferences	500			
Printing and publishing	500	300	242	58
Total planning	17,000	8,000	7,803	197
Street lighting	50,000	56,500	56,461	39
Sanitation:				
Contracted services	83,000	83,500	83,214	286
Capital Outlay:				
Land improvements	80,000	33,762	33,689	73
Financial and administration	15,000	8,700	8,853	47
General	25,000	36,500	273,225	(236,725)
Police	5,000	300	-	300
Total Capital Outlay	125,000	79,262	315,567	(236,305)
Debt Service:				
Principal	42,000	54,317	54,317	
Interest expense	500	46,421	50,731	(4,310)
Total Debt Service	42,500	100,738	105,048	(4,310)

(Continued)

CITY OF HARBOR BEACH, MICHIGAN

**GENERAL FUND
SCHEDULE OF REVENUE, EXPENDITURES AND CHANGE IN FUND BALANCE -
BUDGET AND ACTUAL
YEAR ENDED JUNE 30, 2005**

	<u>ORIGINAL BUDGET</u>	<u>FINAL BUDGET</u>	<u>ACTUAL</u>	<u>VARIANCE WITH FINAL BUDGET - FAVORABLE (UNFAVORABLE)</u>
TOTAL EXPENDITURES	1,415,000	1,457,000	1,692,989	(235,989)
EXCESS OF REVENUE OVER (UNDER) EXPENDITURES	<u>25,000</u>	<u>(11,000)</u>	<u>(242,622)</u>	<u>(231,622)</u>
OTHER FINANCING SOURCES (USES):				
Proceeds from bonds			229,725	229,725
Operating transfers in			12,124	12,124
Operating transfers out	(25,000)	(25,000)	(25,000)	
TOTAL OTHER FINANCING SOURCES (USES)	<u>(25,000)</u>	<u>(25,000)</u>	<u>216,849</u>	<u>241,849</u>
EXCESS OF REVENUE AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	<u>-</u>	<u>(36,000)</u>	<u>(25,773)</u>	<u>10,227</u>
FUND BALANCE - JULY 1	940,502	940,502	940,502	
FUND BALANCE - JUNE 30	<u>\$ 940,502</u>	<u>\$ 904,502</u>	<u>\$ 914,729</u>	<u>\$ 10,227</u>

SUPPLEMENTAL INFORMATION

CITY OF HARBOR BEACH, MICHIGAN

**NONMAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET
JUNE 30, 2005**

	<u>SPECIAL REVENUE</u>			<u>TOTALS</u>	
	<u>MAJOR STREET & TRUNKLINE</u>	<u>LOCAL STREET</u>	<u>CAPITAL PROJECTS</u>	<u>JUNE 30, 2005</u>	<u>2004</u>
<u>ASSETS</u>					
Cash	\$ 218,506	\$ 293,499	\$ 411,635	\$ 923,640	\$ 440,508
Accounts receivable					
Due from other governments	34,992	5,414		40,406	29,525
TOTAL ASSETS	<u>\$ 253,498</u>	<u>\$ 298,913</u>	<u>\$ 411,635</u>	<u>\$ 964,046</u>	<u>\$ 470,033</u>
<u>LIABILITIES AND FUND EQUITY</u>					
Liabilities:					
Accounts payable	\$ 236	\$ 881		\$ 1,117	\$ 12,440
Accrued payroll and related taxes					854
Total liabilities	<u>236</u>	<u>881</u>		<u>1,117</u>	<u>13,294</u>
Fund balance - unreserved	253,262	298,032	\$ 411,635	962,929	456,739
TOTAL LIABILITIES AND FUND EQUITY	<u>\$ 253,498</u>	<u>\$ 298,913</u>	<u>\$ 411,635</u>	<u>\$ 964,046</u>	<u>\$ 470,033</u>

CITY OF HARBOR BEACH, MICHIGAN

**NONMAJOR GOVERNMENTAL FUNDS
COMBINING STATEMENT OF REVENUE, EXPENDITURES
AND CHANGE IN FUND BALANCE
YEAR ENDED JUNE 30, 2005**

	<u>SPECIAL REVENUE</u>		<u>CAPITAL</u>	<u>TOTALS</u>	
	<u>MAJOR STREET & TRUNKLINE</u>	<u>LOCAL STREET</u>	<u>PROJECTS</u>	<u>JUNE 30,</u>	<u>2004</u>
REVENUE:					
Intergovernmental	\$ 134,277	\$ 103,637		\$ 237,914	\$ 243,755
Miscellaneous	3,881	21,764	\$ 4,285	29,930	2,234
TOTAL REVENUE	<u>138,158</u>	<u>125,401</u>	<u>4,285</u>	<u>267,844</u>	<u>245,989</u>
EXPENDITURES:					
Streets	103,757	58,596		162,353	186,614
Administrative	3,950	2,700		6,650	8,050
TOTAL EXPENDITURES	<u>107,707</u>	<u>61,296</u>		<u>169,003</u>	<u>194,664</u>
EXCESS OF REVENUE OVER EXPENDITURES	<u>30,451</u>	<u>64,105</u>	<u>4,285</u>	<u>98,841</u>	<u>51,325</u>
OTHER FINANCING SOURCES (USES):					
Operating transfers in			427,807	427,807	
Operating transfers (out)			(21,113)	(21,113)	
TOTAL OTHER FINANCING SOURCES			<u>406,694</u>	<u>406,694</u>	
EXCESS OF REVENUE AND OTHER SOURCES OVER EXPENDITURES AND OTHER USES	<u>30,451</u>	<u>64,105</u>	<u>410,979</u>	<u>505,535</u>	<u>51,325</u>
FUND BALANCE - JULY 1	222,811	233,927	656	457,394	405,414
FUND BALANCE - JUNE 30	<u>\$253,262</u>	<u>\$298,032</u>	<u>\$ 411,635</u>	<u>\$ 962,929</u>	<u>\$ 456,739</u>

CITY OF HARBOR BEACH, MICHIGAN
MAJOR STREET AND TRUNKLINE FUND
SCHEDULE OF REVENUE, EXPENDITURES AND CHANGE IN FUND BALANCE -
BUDGET AND ACTUAL
YEAR ENDED JUNE 30, 2005

	<u>ORIGINAL BUDGET</u>	<u>FINAL BUDGET</u>	<u>ACTUAL</u>	<u>VARIANCE WITH FINAL BUDGET - FAVORABLE (UNFAVORABLE)</u>
REVENUE:				
Intergovernmental:				
Gas and weight tax	\$ 70,000	\$ 100,600	\$ 100,659	\$ 59
State trunkline maintenance	36,000	33,600	33,618	18
Total Intergovernmental	<u>106,000</u>	<u>134,200</u>	<u>134,277</u>	<u>77</u>
Miscellaneous:				
Interest	2,000	3,800	3,881	81
TOTAL REVENUE	<u>108,000</u>	<u>138,000</u>	<u>138,158</u>	<u>158</u>
EXPENDITURES:				
Construction:				
Materials	35,000			
Total construction	<u>35,000</u>	<u>-</u>	<u>-</u>	<u>-</u>
Routine maintenance:				
Labor	5,000	5,000	4,786	214
Fringe benefits	2,000	2,600	2,584	16
Materials	3,000	2,500	2,442	58
Repairs and maintenance	12,000	28,200	28,190	10
Equipment rental	5,000	7,200	7,103	97
Total routine maintenance	<u>27,000</u>	<u>45,500</u>	<u>45,105</u>	<u>395</u>
Traffic services:				
Labor	1,000	500	482	18
Fringe benefits	100	300	208	92
Materials	500			
Equipment rental	400	200	168	32
Total traffic services	<u>2,000</u>	<u>1,000</u>	<u>858</u>	<u>142</u>
Winter maintenance:				
Labor	8,000	10,000	9,957	43
Fringe benefits	2,000	3,700	3,666	34
Materials	3,000	1,500	1,468	32
Equipment rental	7,000	12,300	12,280	20
Total winter maintenance	<u>20,000</u>	<u>27,500</u>	<u>27,371</u>	<u>129</u>
Administrative:				
Administrative cost	2,000	2,000	2,000	
Professional services	2,000	2,000	1,950	50
Total administrative	<u>4,000</u>	<u>4,000</u>	<u>3,950</u>	<u>50</u>

CITY OF HARBOR BEACH, MICHIGAN
MAJOR STREET AND TRUNKLINE FUND
SCHEDULE OF REVENUE, EXPENDITURES AND CHANGE IN FUND BALANCE -
BUDGET AND ACTUAL
YEAR ENDED JUNE 30, 2005

	<u>ORIGINAL BUDGET</u>	<u>FINAL BUDGET</u>	<u>ACTUAL</u>	<u>VARIANCE WITH FINAL BUDGET - FAVORABLE (UNFAVORABLE)</u>
Trunkline Maintenance:				
Labor	9,000	10,500	10,270	230
Fringe benefits	3,000	4,500	4,367	133
Materials	1,000	1,000	966	34
Equipment rental	<u>7,000</u>	<u>15,000</u>	<u>14,820</u>	<u>180</u>
Total trunkline maintenance	<u>20,000</u>	<u>31,000</u>	<u>30,423</u>	<u>577</u>
TOTAL EXPENDITURES	<u>108,000</u>	<u>109,000</u>	<u>107,707</u>	<u>1,293</u>
EXCESS OF REVENUE OVER EXPENDITURES	<u>-</u>	<u>29,000</u>	<u>30,451</u>	<u>1,451</u>
FUND BALANCE - JULY 1	<u>222,811</u>	<u>222,811</u>	<u>222,811</u>	
FUND BALANCE - JUNE 30	<u>\$ 222,811</u>	<u>\$ 251,811</u>	<u>\$ 253,262</u>	<u>\$ 1,451</u>

CITY OF HARBOR BEACH, MICHIGAN

LOCAL STREET FUND SCHEDULE OF REVENUE, EXPENDITURES AND CHANGE IN FUND BALANCE - BUDGET AND ACTUAL YEAR ENDED JUNE 30, 2005

	ORIGINAL BUDGET	FINAL BUDGET	ACTUAL	VARIANCE WITH FINAL BUDGET - FAVORABLE (UNFAVORABLE)
REVENUE:				
Intergovernmental:				
Gas and weight tax	\$ 31,000	\$ 35,000	\$ 35,550	\$ 550
County road millage	87,000	68,000	68,087	87
Total intergovernmental	<u>98,000</u>	<u>103,000</u>	<u>103,637</u>	<u>637</u>
Miscellaneous:				
Interest	1,500	3,500	3,890	390
Charges	500	17,500	17,874	374
Total miscellaneous	<u>2,000</u>	<u>21,000</u>	<u>21,764</u>	<u>764</u>
TOTAL REVENUE	<u>100,000</u>	<u>124,000</u>	<u>125,401</u>	<u>1,401</u>
EXPENDITURES:				
Construction:				
Labor	1,000			
Fringe benefits	500			
Contracted services	38,000			
Engineering fees	10,000			
Equipment rental	500			
Total construction	<u>50,000</u>	<u>-</u>	<u>-</u>	<u>-</u>
Routine maintenance:				
Labor	5,000	5,900	5,820	80
Fringe benefits	2,000	2,700	2,637	63
Materials	2,000	2,500	2,473	27
Repairs & maintenance	15,000	8,800	8,585	215
Equipment rental	6,000	8,600	8,504	96
Total routine maintenance	<u>30,000</u>	<u>28,500</u>	<u>28,019</u>	<u>481</u>
Traffic services:				
Labor	400	1,300	1,182	118
Fringe benefits	200	500	476	24
Materials	200			
Equipment rental	200	700	548	152
Total traffic services	<u>1,000</u>	<u>2,500</u>	<u>2,206</u>	<u>294</u>
Winter maintenance:				
Labor	6,000	10,000	9,790	210
Fringe benefits	2,000	4,000	3,612	388
Materials	1,000	1,000	1,019	(19)
Equipment rental	5,000	14,000	13,950	50
Total winter maintenance	<u>14,000</u>	<u>29,000</u>	<u>28,371</u>	<u>629</u>
Administrative:				
Administration cost	1,000	1,000	1,000	
Engineering fees	1,000			
Professional services	3,000	2,000	1,700	300
Total administrative	<u>5,000</u>	<u>3,000</u>	<u>2,700</u>	<u>300</u>

(Continued)

CITY OF HARBOR BEACH, MICHIGAN

**LOCAL STREET FUND
SCHEDULE OF REVENUE, EXPENDITURES AND CHANGE IN FUND BALANCE -
BUDGET AND ACTUAL
YEAR ENDED JUNE 30, 2005**

	<u>ORIGINAL BUDGET</u>	<u>FINAL BUDGET</u>	<u>ACTUAL</u>	<u>VARIANCE WITH FINAL BUDGET - FAVORABLE (UNFAVORABLE)</u>
TOTAL EXPENDITURES	100,000	63,000	61,296	1,704
EXCESS OF REVENUE OVER EXPENDITURES	-	61,000	64,105	3,105
FUND BALANCE - JULY 1	233,927	233,927	233,927	
FUND BALANCE - JUNE 30	<u>\$ 233,927</u>	<u>\$294,927</u>	<u>\$298,032</u>	<u>\$ 3,105</u>

CITY OF HARBOR BEACH, MICHIGAN

**SEWER FUND
SCHEDULE OF REVENUE AND EXPENSES - BUDGET AND ACTUAL
YEAR ENDED JUNE 30, 2005**

	<u>FINAL BUDGET</u>	<u>ACTUAL</u>	<u>VARIANCE- FAVORABLE (UNFAVORABLE)</u>
OPERATING REVENUE:			
Sewer service charge	\$ 391,500	\$ 412,457	\$ 20,957
Sewer permits	1,900	1,900	
TOTAL OPERATING REVENUE	<u>393,400</u>	<u>414,357</u>	<u>20,957</u>
OPERATING EXPENSES:			
Salaries	153,000	154,307	(1,307)
Administrative cost	30,000	30,000	
Fringe benefits	68,000	68,278	(278)
Dues and subscriptions	100	100	
Supplies	5,800	6,229	(429)
Postage	700	658	42
Clothing	300	296	4
Chemicals	20,000	20,055	(55)
Education and training	1,000	1,037	(37)
Professional services	4,700	4,596	104
Contracted services	341,300	65,953	275,347
Penalties and fines	500	500	
Licenses and fees	2,000	1,950	50
Telephone	1,100	1,039	61
Transportation	1,200	1,155	45
Insurance	4,800	4,792	8
Utilities	58,000	61,470	(3,470)
Equipment maintenance	7,500	7,574	(74)
Repairs and maintenance	1,700	1,660	40
Equipment rental	7,800	7,736	64
Sewer main maintenance	3,500	3,555	(55)
Equipment replacement	16,400		16,400
Depreciation	3,600	275,389	(271,789)
Amortization		4,274	(4,274)
TOTAL OPERATING EXPENSES	<u>733,000</u>	<u>722,603</u>	<u>10,397</u>
OPERATING LOSS	<u>(339,600)</u>	<u>(308,246)</u>	<u>31,354</u>
NONOPERATING REVENUE (EXPENSES):			
Interest income	11,100	11,082	(18)
Fines and forfeitures	2,000	2,000	
Sale of fixed assets	500	556	56
Property tax levy	55,000	127,484	72,484
Contributions		275,000	275,000
Bond interest expense		(52,456)	(52,456)
Paying agent fees		(141)	(141)
TOTAL NONOPERATING REVENUE (EXPENSES)	<u>68,600</u>	<u>363,525</u>	<u>294,925</u>
INCOME (LOSS) BEFORE OPERATING TRANSFERS	<u>(271,000)</u>	<u>55,279</u>	<u>326,279</u>
OTHER FINANCING SOURCES (USES):			
Operating transfers in		8,989	8,989
Operating transfers out	(273,000)		273,000
TOTAL OTHER FINANCING SOURCES (USES)	<u>(273,000)</u>	<u>8,989</u>	<u>281,989</u>
NET INCOME (LOSS)	<u>\$ (544,000)</u>	<u>\$ 64,268</u>	<u>\$ 608,268</u>

CITY OF HARBOR BEACH, MICHIGAN

WATER SUPPLY FUND SCHEDULE OF REVENUE AND EXPENSES - BUDGET AND ACTUAL YEAR ENDED JUNE 30, 2005

	FINAL BUDGET	ACTUAL	VARIANCE- FAVORABLE (UNFAVORABLE)
OPERATING REVENUE:			
Water sales	\$ 688,500	\$ 688,554	\$ 54
Sale of material and labor	8,000	8,252	252
Water permits	4,000	4,100	100
Fire hydrant rental	60,000	60,000	
TOTAL OPERATING REVENUE	<u>760,500</u>	<u>760,906</u>	<u>406</u>
OPERATING EXPENSES:			
Salaries	172,800	173,178	(378)
Administrative cost	30,000	30,000	
Fringe benefits	81,800	82,055	(255)
Supplies	5,900	7,388	(1,488)
Postage	500	483	17
Chemicals	25,400	25,350	50
Professional services	7,000	6,916	84
Contracted services	29,600	1,148	28,452
Telephone	600	602	(2)
Transportation	400	391	9
Insurance	5,600	5,515	85
Utilities	61,000	60,795	205
Equipment maintenance	2,700	2,692	8
Repairs and maintenance	6,000	5,915	85
Maintenance of mains	7,000	6,917	83
Maintenance of grounds	100	42	58
Equipment rental	13,000	12,900	100
Education and training	300	300	
Depreciation	292,000	293,631	(1,631)
Amortization		1,195	(1,195)
TOTAL OPERATING EXPENSES	<u>741,700</u>	<u>717,413</u>	<u>24,287</u>
OPERATING INCOME	<u>18,800</u>	<u>43,493</u>	<u>24,693</u>
NONOPERATING REVENUE (EXPENSES):			
Property taxes	56,000	183,967	127,967
Contributions from customers	124,000	578,666	454,666
Paying agent fees		(302)	(302)
Interest income	12,500	12,611	111
Interest expense	(113,300)	(210,188)	(96,888)
TOTAL NONOPERATING REVENUE	<u>79,200</u>	<u>564,754</u>	<u>485,554</u>
INCOME BEFORE OPERATING TRANSFERS	<u>98,000</u>	<u>608,247</u>	<u>510,247</u>
OTHER FINANCING USES:			
Operating transfers out		(427,807)	(427,807)
NET INCOME	<u>\$ 98,000</u>	<u>\$ 180,440</u>	<u>\$ 82,440</u>

CITY OF HARBOR BEACH, MICHIGAN

**RECREATION FUND
SCHEDULE OF REVENUE AND EXPENSES - BUDGET AND ACTUAL
YEAR ENDED JUNE 30, 2005**

	FINAL BUDGET	ACTUAL	VARIANCE- FAVORABLE (UNFAVORABLE)
OPERATING REVENUE:			
Fees for marina services	\$ 103,200	\$ 105,827	\$ 2,427
Sale of marina material and labor	158,700	157,305	605
Rentals	180,000	185,843	5,843
Retail merchandise	3,600	3,622	22
Recreation fees		4,038	4,038
Trip fees	4,500	4,570	70
Membership fees	8,400	8,480	80
Storage fees	9,900	10,035	135
TOTAL OPERATING REVENUE	<u>468,300</u>	<u>479,520</u>	<u>13,220</u>
OPERATING EXPENSES:			
Salaries	151,900	151,219	681
Administrative cost	15,000	15,000	
Office expense	4,800	135	4,465
Fringe benefits	39,600	39,033	567
Supplies and tools	33,500	30,689	2,811
Merchandise	120,500	120,413	87
Professional services	2,500	2,200	300
Contracted services	4,600	4,468	132
Telephone	3,400	3,142	258
Transportation	500	484	16
Community promotion	4,200	3,581	619
Sanctioning fees	1,700	1,698	2
Printing & publishing	1,400	1,297	103
Postage	1,300	988	332
Insurance	5,900	5,822	78
Utilities	68,900	72,752	(3,852)
Repairs and maintenance	42,300	34,054	8,246
Equipment rental	7,900	7,518	382
Dues and subscriptions	2,100	2,012	88
License	200	200	
Diesel tax	3,600	3,563	37
State sales tax	8,500	8,342	158
Depreciation	158,500	160,353	(1,853)
Event charges	2,100	2,005	95
Special event expenses	10,700	10,650	50
Umpire fees	1,600	1,540	60
Bank Charge - Credit cards	6,000	5,855	145
Capital outlay	125,000		125,000
TOTAL OPERATING EXPENSES	<u>828,000</u>	<u>688,993</u>	<u>139,007</u>
OPERATING LOSS	<u>(361,700)</u>	<u>(209,472)</u>	<u>152,227</u>
NONOPERATING REVENUE (EXPENSE):			
Interest income	300	389	89
Sale of fixed assets	13,900	(1,842)	(15,742)
Contributions	20,500	18,774	(1,727)
Grant income		40,000	40,000
Interest expense		(3,474)	(3,474)
TOTAL NONOPERATING REVENUE	<u>34,700</u>	<u>53,847</u>	<u>19,147</u>
LOSS BEFORE OPERATING TRANSFERS	<u>(327,000)</u>	<u>(155,625)</u>	<u>171,375</u>
OTHER FINANCING SOURCES:			
Operating transfers in	25,000	25,000	
NET LOSS	<u>\$ (302,000)</u>	<u>\$ (130,625)</u>	<u>\$ 171,375</u>

CITY OF HARBOR BEACH, MICHIGAN

INTERNAL SERVICE FUND SCHEDULE OF REVENUE AND EXPENSES - BUDGET AND ACTUAL YEAR ENDED JUNE 30, 2005

	<u>FINAL BUDGET</u>	<u>ACTUAL</u>	<u>VARIANCE- FAVORABLE (UNFAVORABLE)</u>
OPERATING REVENUE:			
Rental of equipment	<u>\$ 155,500</u>	<u>\$ 156,047</u>	<u>\$ 547</u>
OPERATING EXPENSES:			
Salaries	10,000	9,163	837
Administrative cost	1,000	1,000	
Fringe benefits	4,400	4,376	24
Supplies and tools	3,000	2,973	27
Repair parts	4,500	4,593	(93)
Professional services	1,300	1,230	70
Telephone	1,000	853	147
Gas and oil	15,000	15,096	(96)
Insurance	5,200	5,112	88
Equipment maintenance	3,000	3,011	(11)
Capital outlay	7,600		7,600
Depreciation		53,823	(53,823)
TOTAL OPERATING EXPENSES	<u>56,000</u>	<u>101,231</u>	<u>(45,230)</u>
OPERATING INCOME	<u>99,500</u>	<u>54,816</u>	<u>(44,683)</u>
NONOPERATING REVENUE:			
Interest income	10,500	10,793	293
Sale of fixed assets	3,000	3,000	
TOTAL NONOPERATING REVENUE	<u>13,500</u>	<u>13,793</u>	<u>293</u>
NET INCOME	<u>\$ 113,000</u>	<u>\$ 68,609</u>	<u>\$ (44,390)</u>

CITY OF HARBOR BEACH, MICHIGAN

ENTERPRISE FUNDS
SCHEDULE OF CAPITAL ASSETS AND ACCUMULATED DEPRECIATION
YEAR ENDED JUNE 30, 2005

	CAPITAL ASSETS			ACCUMULATED DEPRECIATION				NET ASSET COST
	BALANCE JUNE 30, 2004	ADDITIONS	RETIREMENTS	BALANCE JUNE 30, 2005	PROVISION FOR DEPRECIATION	RETIREMENTS	BALANCE JUNE 30, 2005	
SEWER FUND:								
Buildings	\$ 1,052,143	\$ 16,320		\$ 1,052,143	\$ 26,304		\$ 460,319	\$ 591,824
Equipment	4,284,858			4,301,178	182,274		3,000,667	1,300,511
Sewer lines	1,739,875	173,726		1,913,401	66,811		693,081	1,220,320
TOTAL SEWER FUND	7,076,676	190,046	-	7,266,722	275,389	-	4,154,067	3,112,655
WATER SUPPLY FUND:								
Buildings	2,540,310			2,540,310	465,723		516,529	2,023,781
Equipment	1,859,872	28,553		1,888,425	158,206		1,786,182	102,243
Water mains	3,996,427	521,291		4,517,718	82,533		704,115	3,813,603
Water tower	104,282			104,282	2,086		71,962	32,320
TOTAL WATER SUPPLY FUND	8,500,891	549,844	-	9,050,735	293,631	-	3,078,788	5,971,947
RECREATION FUND:								
Land	66,530			66,530				66,530
Buildings	664,071	1,533		665,604	24,799		320,315	345,289
Docks	799,646			799,646	5,658		780,793	18,853
Harbor & parking lot	1,852,994			1,852,994	62,382		1,054,656	798,338
Machinery & equipment	748,702	133,155	24,570	852,287	23,413	8,898	659,912	197,375
Sites & improvements	1,019,794	4,721		1,024,515	44,101		552,311	472,204
TOTAL PARKS AND RECREATION FUND	5,151,737	139,409	24,570	5,266,576	160,353	8,898	3,367,987	1,898,589
TOTALS	\$ 20,729,304	\$ 879,299	\$ 24,570	\$ 21,584,033	\$ 9,880,367	\$ 8,898	\$ 10,600,842	\$ 10,983,190

CITY OF HARBOR BEACH, MICHIGAN

**SCHEDULE OF PRINCIPAL AND INTEREST REQUIREMENTS
1993 WATER SUPPLY AND DISTRIBUTION SYSTEM REVENUE BONDS
AT JUNE 30, 2005**

MATURITY		INTEREST		
<u>DATE</u>	<u>PRINCIPAL</u>	<u>RATE</u>	<u>AMOUNT</u>	<u>TOTAL</u>
11/01/05	\$ 63,000	5.25%	\$ 85,260	\$ 148,260
05/01/06			83,606	83,606
11/01/06	66,000	5.25	83,606	149,606
05/01/07			81,874	81,874
11/01/07	70,000	5.25	81,874	151,874
05/01/08			80,036	80,036
11/01/08	74,000	5.25	80,036	154,036
05/01/09			78,094	78,094
11/01/09	77,000	5.25	78,094	155,094
05/01/10			76,073	76,073
11/01/10	81,000	5.25	76,073	157,073
05/01/11			73,946	73,946
11/01/11	86,000	5.25	73,946	159,946
05/01/12			71,689	71,689
11/01/12	90,000	5.25	71,689	161,689
05/01/13			69,326	69,326
11/01/13	95,000	5.25	69,326	164,326
05/01/14			66,833	66,833
11/01/14	100,000	5.25	66,833	166,833
05/01/15			64,208	64,208
11/01/15	105,000	5.25	64,208	169,208
05/01/16			61,451	61,451
11/01/16	111,000	5.25	61,451	172,451
05/01/17			58,538	58,538
11/01/17	116,000	5.25	58,538	174,538
05/01/18			55,492	55,492
11/01/18	123,000	5.25	55,492	178,492
05/01/19			52,264	52,264
11/01/19	129,000	5.25	52,264	181,264
05/01/20			48,877	48,877
11/01/20	136,000	5.25	48,877	184,877
05/01/21			45,307	45,307
11/01/21	143,000	5.25	45,307	188,307
05/01/22			41,554	41,554
11/01/22	150,000	5.25	41,554	191,554
05/01/23			37,616	37,616
11/01/23	158,000	5.25	37,616	195,616
05/01/24			33,469	33,469
11/01/24	167,000	5.25	33,469	200,469
05/01/25			29,085	29,085
11/01/25	175,000	5.25	29,085	204,085

CITY OF HARBOR BEACH, MICHIGAN

**SCHEDULE OF PRINCIPAL AND INTEREST REQUIREMENTS
1993 WATER SUPPLY AND DISTRIBUTION SYSTEM REVENUE BONDS
AT JUNE 30, 2005**

MATURITY DATE	PRINCIPAL	INTEREST		TOTAL
		RATE	AMOUNT	
05/01/26			24,491	24,491
11/01/26	185,000	5.25	24,491	209,491
05/01/27			19,635	19,635
11/01/27	194,000	5.25	19,635	213,635
05/01/28			14,542	14,542
11/01/28	204,000	5.25	14,542	218,542
05/01/29			9,187	9,187
11/01/29	215,000	5.25	9,187	224,187
05/01/30			3,544	3,544
11/01/30	135,000	5.25	3,544	138,544
TOTALS	<u>\$ 3,248,000</u>		<u>\$ 2,646,734</u>	<u>\$ 5,894,734</u>

CITY OF HARBOR BEACH, MICHIGAN

**SCHEDULE OF PRINCIPAL AND INTEREST REQUIREMENTS
2000 GENERAL OBLIGATION PUBLIC IMPROVEMENT BONDS
AT JUNE 30, 2005**

MATURITY			INTEREST	
DATE	PRINCIPAL	RATE	AMOUNT	TOTAL
11/01/05			\$ 67,372	\$ 67,372
05/01/06	\$ 65,000	5.125%	67,372	132,372
11/01/06			65,707	65,707
05/01/07	75,000	5.125	65,707	140,707
11/01/07			63,784	63,784
05/01/08	85,000	5.125	63,784	148,784
11/01/08			61,606	61,606
05/01/09	95,000	5.125	61,606	156,606
11/01/09			59,172	59,172
05/01/10	110,000	5.125	59,172	169,172
11/01/10			56,353	56,353
05/01/11	125,000	5.125	56,353	181,353
11/01/11			53,150	53,150
05/01/12	140,000	5.125	53,150	193,150
11/01/12			49,563	49,563
05/01/13	155,000	5.35	49,563	204,563
11/01/13			45,416	45,416
05/01/14	170,000	5.35	45,416	215,416
11/01/14			40,869	40,869
05/01/15	190,000	5.35	40,869	230,869
11/01/15			35,786	35,786
05/01/16	210,000	5.45	35,786	245,786
11/01/16			30,064	30,064
05/01/17	235,000	5.45	30,064	265,064
11/01/17			23,660	23,660
05/01/18	260,000	5.60	23,660	283,660
11/01/18			16,380	16,380
05/01/19	285,000	5.60	16,380	301,380
11/01/19			8,400	8,400
05/01/20	300,000	5.60	8,400	308,400
TOTALS	\$ 2,500,000		\$ 1,354,564	\$ 3,854,564

CITY OF HARBOR BEACH, MICHIGAN

**SCHEDULE OF PRINCIPAL AND INTEREST REQUIREMENTS
2004 GENERAL OBLIGATION CAPITAL IMPROVEMENT BONDS
AT JUNE 30, 2005**

MATURITY DATE	PRINCIPAL	INTEREST		TOTAL
		RATE	AMOUNT	
11/01/05			\$ 20,939	\$ 20,939
05/01/06	\$ 35,000	3.500%	20,939	55,939
11/01/06			20,326	20,326
05/01/07	35,000	3.600	20,326	55,326
11/01/07			19,696	19,696
05/01/08	35,000	3.750	19,696	54,696
11/01/08			19,040	19,040
05/01/09	40,000	3.900	19,040	59,040
11/01/09			18,260	18,260
05/01/10	40,000	4.000	18,260	58,260
11/01/10			17,460	17,460
05/01/11	40,000	4.150	17,460	57,460
11/01/11			16,630	16,630
05/01/12	40,000	4.300	16,630	56,630
11/01/12			15,770	15,770
05/01/13	45,000	4.400	15,770	60,770
11/01/13			14,780	14,780
05/01/14	45,000	4.500	14,780	59,780
11/01/14			13,768	13,768
05/01/15	45,000	4.500	13,768	58,768
11/01/15			12,755	12,755
05/01/16	50,000	4.600	12,755	62,755
11/01/16			11,605	11,605
05/01/17	50,000	4.700	11,605	61,605
11/01/17			10,430	10,430
05/01/18	50,000	4.800	10,430	60,430
11/01/18			9,230	9,230
05/01/19	55,000	4.850	9,230	64,230
11/01/19			7,896	7,896
05/01/20	55,000	5.000	7,896	62,896
11/01/20			6,521	6,521
05/01/21	60,000	5.000	6,521	66,521
11/01/21			5,021	5,021
05/01/22	60,000	5.150	5,021	65,021
11/01/22			3,476	3,476
05/01/23	65,000	5.150	3,476	68,476
11/01/23			1,803	1,803
05/01/24	70,000	5.150	1,803	71,803
TOTALS	\$ 915,000		\$ 490,813	\$ 1,405,813

CITY OF HARBOR BEACH, MICHIGAN

SCHEDULE OF PRINCIPAL AND INTEREST REQUIREMENTS 2003 INSTALLMENT PURCHASE AGREEMENT AT JUNE 30, 2005

MATURITY DATE	PRINCIPAL	INTEREST		TOTAL
		RATE	AMOUNT	
10/01/05	\$ 25,000	3.190%	\$ 7,975	\$ 32,975
04/01/06			7,576	7,576
10/01/06	25,000	3.190	7,576	32,576
04/01/07			7,178	7,178
10/01/07	30,000	3.190	7,178	37,178
04/01/08			6,699	6,699
10/01/08	30,000	3.190	6,699	36,699
04/01/09			6,221	6,221
10/01/09	30,000	3.190	6,221	36,221
04/01/10			5,742	5,742
10/01/10	30,000	3.190	5,742	35,742
04/01/11			5,264	5,264
10/01/11	35,000	3.190	5,264	40,264
04/01/12			4,705	4,705
10/01/12	35,000	3.190	4,705	39,705
04/01/13			4,147	4,147
10/01/13	40,000	3.190	4,147	44,147
04/01/14			3,509	3,509
10/01/14	40,000	3.190	3,509	43,509
04/01/15			2,871	2,871
10/01/15	40,000	3.190	2,871	42,871
04/01/16			2,233	2,233
10/01/16	45,000	3.190	2,233	47,233
04/01/17			1,515	1,515
10/01/17	45,000	3.190	1,515	46,515
04/01/18			798	798
10/01/18	50,000	3.190	798	50,798
TOTALS	\$ 500,000		\$ 124,889	\$ 624,889



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CPA's On Your Team

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING
STANDARDS**

To the City Council
City of Harbor Beach, Michigan

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Harbor Beach, Michigan, as of and for the year ended June 30, 2005, which collectively comprise the City of Harbor Beach, Michigan's basic financial statements and have issued our report thereon dated August 17, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered City of Harbor Beach, Michigan's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether City of Harbor Beach, Michigan's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the management, City Council, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Nietzke & Faupel, PC
NIETZKE & FAUPEL, P.C.
PIGEON, MICHIGAN

August 17, 2005